edited by

Zhang Peiji

and

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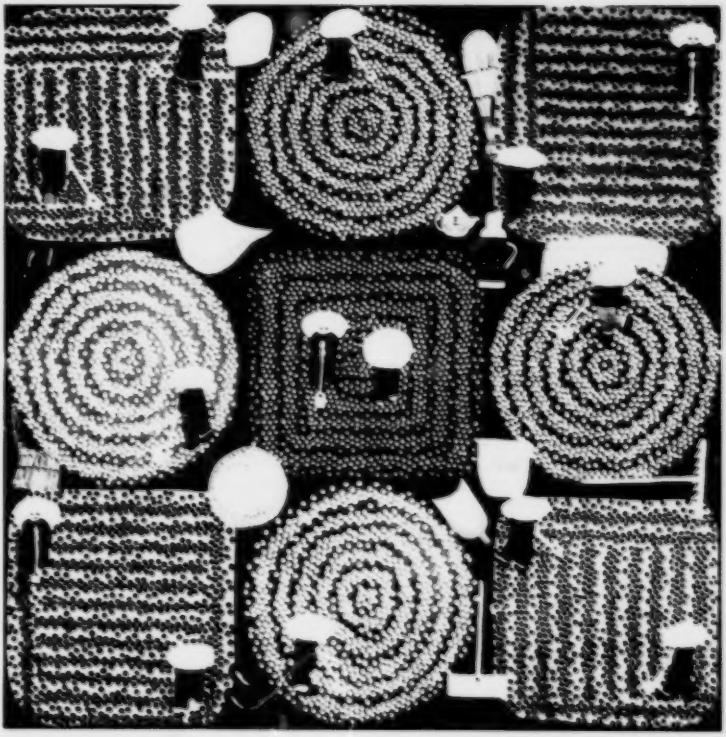

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CHINA'S FOREIGN TRADE

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edited by
Zhang Peiji
and
Ralph Huenemann

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The publishers and editors express their gratitude to Ross and Judy Fraser for the use of the painting "Drying Grain" by He Yaling on the cover.

Preface

During their visit to China in December, 1985, Dr. John Whalley, Director of the Centre for Study of International Economic Relations of the University of Western Ontario in Canada, and Dr. Jaine Serra, Director of the Research Centre for International Economic Relations in Mexico, suggested to the International Trade Research Institute (ITRI) of the Ministry of Foreign Economic Relations and Trade (MOFERT) that a book on the development of China's foreign trade be jointly published to provide more information on China's open policy. With the active support of the Canadian Institute for Research on Public Policy (IRPP) and its president, Dr. A. R. Dobell, this book has now been published. Dr. Ralph W. Huenemann of IRPP provided significant editorial assistance. I sincerely hope that to our Canadian friends this book will be helpful in understanding China, especially the development of China's foreign trade since the adoption of the open policy. I also hope it will be conducive to promoting economic and trade relations between the two countries.

I would like to thank all the authors who have contributed to this volume. Most of the authors are research personnel attached to the various departments of ITRI. We are particularly grateful to the following persons for their valuable contributions: Madam Wu Chao, senior research fellow of the Research Centre for Economic, Technical and Social Development under the State Council; Mr. Dong Shangming and Mr. Wang Lei of the Department of International Relations of MOFERT; and Mr. Wu Jikun, Deputy General Manager of the International Tendering Company of China National Technology Import Corporation.

Our thanks also go to Drs. Dobell, Whalley, and Huenemann for their active support and friendly co-operation.

Zhang Peiji,
Director of the International Trade
Research Institute,
Ministry of Foreign Economic Relations
and Trade,
People's Republic of China

Préface

Lors de leur visite en Chine en décembre 1985, le Dr. John Whalley, directeur du "Centre for Study of International Economic Relations" a l'université de Western Ontario, au Canada, et le Dr. Jaine Serra, directeur du "Research Centre for International Economic Relations" au Mexique, avaient suggéré au "Ministry of Foreign Economic Relations and Trade" (MOFERT) qu'un livre sur le développement des politiques sur le commerce extérieur de la Chine soit publié conjointement, afin de mieux faire connaître les politiques d'ouverture de la Chine. Grâce à l'appui de l'Institut de recherches politiques et de son président, le Dr. Rod Dobell, la réalisation de ce livre a été rendue possible. Le Dr. Ralph W. Huenemann de l'Institut nous a fourni une aide considérable au niveau de l'édition. J'espère sincèrement que ce livre permettra à nos amis canadiens de mieux comprendre la Chine en général, et en particulier le développement de son commerce extérieur, surtout depuis l'adoption des politiques d'ouverture. J'espère aussi que ce livre va contribuer à promouvoir les relations économiques et commerciales entre les deux pays.

Je voudrais remercier tous les auteurs qui ont collaboré à ce livre. La plupart d'entre eux font partie du personnel de recherche oeuvrant dans les différentes divisions de l'ITRI. Nous sommes en particulier redevables aux personnes dont les noms suivent: Madame Wu Chao, chercheur émérite du "Research Centre for Economic, Technical and Social Development," qui dépend du Conseil d'Etat; M. Dong Shangming et M. Wang Lei du "Department of International Relations du MOFERT," et M. Wu Jikun, directeur général adjoint de l'International Tendering Company de la China National Technology Import Corporation.

Nous voudrions égalemont remercier le Dr. Dobell, le Dr. Whalley et Dr. Huenemann pour leur appui, ainsi que pour la coopération amicale qu'ils ont bien voulu nous apporter.

Zhang Peiji, Directeur
International Trade Research Institute
Ministry of Foreign Economic Relations
and Trade
République Populaire de Chine

前言

加拿大西安大略大学国际经济关系研究中心主任约翰威莱(John Whalley)先生和墨西哥学院国际经济关系研究中心主任哈伊梅赛勒(Jaime Serra)先生于1985年12月来华访问期间，在与中华人民共和国对外经济贸易部国际贸易研究所商谈合作项目时提议，为使加拿大各界朋友了解对外开放后的中国，建议合作出版一本英文的介绍中国对外贸易发展的书籍。 由于得到加拿大公共政策研究所，尤其是所长杜倍尔博士(A.R. Dobell)和研究员胡永年博士(R.W.Huenemann)的大力支持，这本书终于公开出版了，并与读者见面。衷心希望这本书对加拿大各界朋友了解中国，尤其是了解对外开放后中国对外贸易发展有一定帮助，能积极促进两国间的经济贸易关系的发展。

深切感谢参加本书编写的作者。他们大部分为我所有关部门的研究人员，同时也特邀了国务院经济技术社会发展研究中心高级研究员武超女士，经贸部国际联络局董尚明，王磊先生和中国技术进口总公司国际招标公司副总经理吴际坤先生参加本书的编写。在此对他们的大力支持表示感谢。

再次深切感谢加拿大公共政策研究所杜倍尔，威莱，和胡永年博士的大力支持和友好的合作。

张培基
国际贸易研究所所长
对外经济贸易部

Foreword

When Marco Polo went to China more than six centuries ago, he discovered a tasty noodle dish called "zha jiang mian" and brought the recipe home with him; the Italians have been enjoying spaghetti ever since. Early in this century, Western business people dreamed of making their fortunes by selling "oil for the lamps of China." In Canada, the Wheat Board has been exporting large quantities of grain to China for more than a quarter of a century. As these brief examples indicate, fascination with China and the desire to exchange ideas and products with "Far Cathay" is nothing new for the West in general, or for Canada in particular.

What is relatively new, I think, is the growing recognition by Canadians that trade with Asia is increasingly important to our economy. This new awareness on the Canadian side is paralleled by a significant policy shift on the Chinese side since the inauguration of the Open Door policy in 1978. As the authors in this volume make clear, Chinese policymakers now view trade not as a passive balancing mechanism but as an active development tool.

This new environment on both sides of the Pacific, while certainly a cause for optimism, does not mean that all contentious trade issues have disappeared. We believe, however, that a candid and constructive discussion of these problems may provide a basis for their ultimate resolution. For that reason, our Institute is happy to publish this collection of papers, which present an articulate and authoritative view of China's hopes and concerns in the realm of trade and investment. This document thus represents a welcome addition to The Institute's growing list of publications exploring important features of Canada's relationships with nations of the Asia-Pacific region. It joins earlier IRPP publications, for example, on Japan (*Canadian Perspectives on Economic Relations with Japan*, *Japanese Business in Canada: The Elusive Alliance*, *Sogoshosha: Engines of Export-Based Growth*, *A Yen for Profit: Canadian Financial Institutions in Japan*), the newly-industrialized countries (*Canada and the Little Dragons*), and the Asia-Pacific region more generally (*Canada and the Pacific Rim*, Volume II of the proceedings of a 1983 IRPP conference on Canada and International Trade). It also represents the beginning, we hope, of a sustained program of analysis not only of Canada's economic relationships with China and other

countries of the Pacific, but also of common interests in the changing role of governments in the Asia Pacific region, and in the emergence of a variety of regional groupings. Although we have provided editorial assistance in preparing these papers for a Western audience, we have tried to preserve the flavour and point of view of the Chinese originals. For the benefit of Canadian readers, however, we have added a brief final article that summarizes the bilateral trade pattern between Canada and China. Our colleagues at the International Trade Research Institute bear no responsibility for this final chapter, though they have graciously consented to this Canadian addendum. For additional background on the Open Door policy, readers are encouraged to consult the paper by Samuel P. S. Ho and Ralph W. Huenemann that appeared in the 1983 conference proceedings volume just cited. Ho and Huenemann give an excellent overview of China's current development strategy.

We are pleased to be able to bring this collection to a wider audience, and we very much look forward to opportunities for collaborative research by ITRI and IRPP in the future.

Rod Dobell
President
Institute for Research on Public Policy

Avant-propos

Lors de son voyage en Chine, il y a plus de six siècles, Marco Polo découvrit un mets délicieux composé de nouilles, appelé "zha jiang mian." Il rapporta la recette dans son pays et c'est depuis lors que les Italiens prennent plaisir à manger des spaghettis. Au début du vingtième siècle, des hommes d'affaires du monde occidental, ont rêvé de faire fortune en vendant "de l'huile pour les lampes de Chine." Au Canada, la Commission canadienne du blé exporte de grandes quantités de céréales en Chine depuis plus d'un quart de siècle. Comme l'indiquent les exemples qui précèdent, la fascination exercée par la Chine et le désir d'échanger idées et produits avec la "lointaine Cathay" ne sont choses nouvelles ni pour l'ouest en général, ni pour le Canada en particulier.

Ce qui est relativement nouveau, c'est que les Canadiens reconnaissent de plus en plus, que le commerce avec l'Asie prend une importance grandissante pour leur économie. Cette prise de conscience du côté canadien va de pair avec d'importants changements politiques en Chine surtout depuis l'inauguration de la politique dite des "portes-ouvertes" en 1978. Comme les auteurs de ce volume le font remarquer, les politiciens chinois considèrent maintenant le commerce extérieur non comme un mécanisme passif de la balance commerciale, mais comme un outil dynamique de développement.

L'existence de cette évolution des mentalités des deux côtés du Pacifique, bien qu'encourageante, ne signifie pas que toutes les questions litigieuses concernant le commerce ont disparu. Nous pensons cependant qu'une discussion franche et constructive de ces problèmes pourrait mener à la résolution de ces derniers. Pour cette raison, notre Institut est heureux de publier cette série d'articles, qui présentent, d'un point de vue éclairé et s'appuyant sur des sources sûres, les espoirs et les inquiétudes de la Chine dans le domaine du commerce et des investissements à l'étranger. Ce document constitue donc un ajout opportun à la liste déjà longue des publications de l'Institut sur les relations du Canada avec les pays de la région du Pacifique asiatique. Il vient compléter des publications portant entre autres sur: le Japon (*Canadian Perspectives on Economic Relations with Japan, Japanese Business in Canada: The Elusive Alliance, Sogoshosha: Engines of Export-based Growth, A Yen for Profit: Canadian Financial Institutes in Japan*), sur les pays nouvellement

industrialisés (*Canada and the Little Dragons*), et sur la région du Pacifique asiatique en général (*Canada and the Pacific Rim*, Volume II des comptes-rendus de la conférence organisée par l'Institut en 1983 sur le Canada et le commerce international). Le volume marque également le début, du moins nous l'espérons, d'un programme de recherches qui porterait non seulement sur les relations économiques du Canada avec la Chine et les autres pays du Pacifique, mais également sur d'autres sujets d'intérêt commun: en particulier l'évolution du rôle des gouvernements dans la région du Pacifique asiatique et l'apparition d'un certain nombre de groupements régionaux. Bien que nous ayons contribué à l'édition de ces documents, afin de les rendre plus accessibles à un audience des pays de l'ouest, nous avons essayé de préserver autant que possible le saveur et le point de vue du texte chinois original. A l'intention du lecteur canadien, cependant, nous avons ajouté à la fin du volume un court article décrivant le profil du commerce existant entre la Chine et le Canada. Nos collègues de l'International Trade Research Institute ont aimablement consenti à cet addendum, mais ils ne sauraient en aucun cas être considérés comme responsables de son contenu. Pour plus d'information sur la politique "portes ouvertes" de la Chine, nous incitons le lecteur à consulter le document rédigé par Samuel P. S. Ho et Ralph W. Huenemann, paru dans les comptes-rendus de la conférence organisée par l'Institut en 1983 et dont la référence est citée plus haut. Messieurs Ho et Huenemann y donnent un excellent aperçu de la stratégie de développement adoptée présentement par la Chine.

Nous sommes heureux de pouvoir permettre un plus grande diffusion de ce document et nous espérons beaucoup avoir l'ocassion de collaborer à nouveau avec l'ITRI dans l'avenir.

Rod Dobell
Président
Institut de recherches politiques

序

马克波罗六百多年前去中国时，就品尝到美味的炸酱面，并把他带回去，介绍给意大利人民，从此通心粉便应运而生了。本世纪初，西方商人梦想着拿卖给中国灯油发笔横财。二，三十年来，加拿大一直向中国出口大量的粮食。这些简单的事例表明，中国的魅力以及期待与这<东方巨龙>互通感情和贸易的愿望对整个西方世界（特别是加拿大）来说已经由来已久了。

我以为新的趋势倒是越来越多的加拿大人意识到与亚洲贸易会对我们的经济有很重大的影响。与这一新认识相对应的是中国从1978年施行开放政策以来的重大政策变革。正如本书作者们指出的那样，中国当今决策人不单单把贸易作为一个消极的杠杆，而是作为一件积极的发展工具。

太平洋两岸的新局面当然值得我们高兴，但这并不意味着所有棘手的贸易问题都已经消除了。我们相信坦率和建设性的协商会有助于问题的最终解决。　有鉴于此，我们有幸出版这本论点明确阐述中国未来贸易和投资的权威性论文集。他是本所出版的一系列探讨加拿大与亚太地区国家关系发展问题的专著中又一诱人的文集，同时也成为已出版的有关日本、新型工业化国家及亚太地区国家概况的姊妹篇。我们希望，这不仅是我们今后长期研究加拿大与中国及其他太平洋地区国家经济关系的开端，同时也能成为我们开始关注亚太地区政治角色变更和各种地区新组合的起点。尽管我们在编写这些稿件的过程中照顾到西方读者的特点，我们还是保留了中文原件的风格和观点，最后还专为加拿大读者加写了一希综述，总结了中加两国双边贸易模式。国际贸易研究所的同行们赞同最后这章加拿大专稿，但对其中的观点，不负担任何责任。若读者希望进一步了解有关开放政策的问题，请参阅何保山和胡永年在1983年会议上所做的报告。他们对中国现行的发展战略作了出色的全面分析。

我们很高兴能将此书呈现给广大读者，并期待着将来我们会有更多的合作研究机会。

杜倍尔
公共政策研究所所长

1

Introduction and Overview

Zhang Peiji

Foreign trade is an important part of China's national economy and a bridge between China and other countries. At the same time, foreign trade activities are an important aspect of China's foreign policy.

Since the founding of the People's Republic in 1949, China has actively organized exports and developed foreign trade, thus earning large amounts of foreign exchange needed by the state. As a result we have been able to import advanced foreign technology, key equipment, and large quantities of raw and semi-finished materials, as well as consumer goods needed by the people. Foreign trade has played an important role in developing production, improving technology, enlivening the market, improving people's livelihood, increasing the capacity for self-reliance, accelerating socialist modernization, and developing positive foreign relations.

The implementation of the open policy and the reform of the domestic economy since the Third Plenum in 1978 have strengthened the role of foreign trade in China's national economy.

I. Foreign Trade Development Since the Birth of New China

Since the founding of the People's Republic, and especially since 1978, foreign trade has developed rapidly alongside the growth of the national economy. According to statistics of the Ministry of Foreign Economic Relations and Trade (MOFERT), total merchandise trade in 1986 stood at US $60.7 billion (with imports of US $34.9 billion and exports of US $25.8 billion), representing an increase of more than fifty-fold over the trade volume of 1950. (For further details of China's balance of payments during the last five years, see Table 1.1 on page 2.)

Shortly after the founding of the People's Republic, the countries aligned with the United States imposed a blockade and embargo on trade with China. In an attempt to weaken our young People's Republic they would not sell advanced technology, equipment, or important materials to us. To cope with this situation, we primarily developed trade with the Soviet Union and East European countries, and at the same time we worked to circumvent the imperialist

embargo by developing trade with capitalist countries that did not fully accept the American point of view. During China's First Five-Year Plan (1953-57), the 156 turn-key industrial projects imported from the Soviet Union provided the backbone of China's industrial construction. In the 1950s foreign trade developed fairly rapidly,

Table 1.1
China's Balance of Payments, 1982-86
(US$ million)

	1982	*1983*	*1984*	*1985*	*1986*
A. Current Account	5,674	4,240	2,030	(11,417)	(7,034)
1. Merchandise	4,249	1,990	14	(13,123)	(9,140)
Exports (FOB)	21,125	20,707	23,905	25,108	25,756
Imports (FOB)	16,876	18,717	23,891	38,231	34,896
2. Services	939	1,739	1,574	1,463	1,727
Credits	3,604	4,028	4,819	4,532	4,927
Debits	2,665	2,289	3,245	3,069	3,200
3. Unrequited Transfers (Net)	486	511	442	243	379
Private Sector	530	436	305	171	255
Public Sector	(44)	75	137	72	124
B. Capital Account	338	(226)	(1,003)	8,972	5,943
1. Long-Term	389	49	(113)	6,701	8,238
Inflow	3,312	2,702	4,128	9,531	11,393
Outflow	2,923	2,653	4,241	2,830	3,155
2. Short-Term	(51)	(275)	(890)	2,271	(2,295)
Inflow	244	59	223	11,346	9,343
Outflow	295	334	1,113	9,075	11,638
C. Errors and Omissions	279	(366)	(932)	92	(184)
D. Change in Reserves	(6,291)	(3,648)	(95)	2,353	1,275

NOTES

[1] Merchandise trade figures are based on statistics from the Customs.

[2] Labour services include shipping costs, insurance premiums, harbour fees, investment income, interest payments, etc.

[3] Unrequited transfers include overseas remittances by private individuals and official gifts and donations.

[4] Long-term capital involves a repayment period of more than one year.

[5] Short-term capital involves a repayment period of less than one year.

[6] Reserves include gold, foreign exchange, and Special Drawing Rights with the International Monetary Fund. By convention, additions to reserves are shown as negative entries (in effect, imports of gold) and reductions of reserves are shown as positive entries.

SOURCE: Beijing Review, September 7, 1987, p. 28.

with import and export volume growing at an average annual rate of 12.9 percent, slightly faster than the growth of domestic industrial and agricultural output.

In the late 1950s and early 1960s, China's national economy suffered serious setbacks. These setbacks were mainly due to the mistakes of the "Great Leap Forward" and the "anti-right deviation struggle," plus the natural disasters of that period and the Soviet government's perfidious act of scrapping contracts and withdrawing its technical advisers. In order to overcome economic difficulties at that time, China had to import a considerable amount of grain, animal and vegetable oils, sugar, and certain other important materials. At the same time, the Soviet government insisted on prompt repayment of our debts. The people of the whole country worked hard and lived thriftily to support exports, so as to pay the debts owed the Soviet Union and earn the foreign exchange needed for importing grain and other materials. The imports during that period played a great role in overcoming temporary difficulties, stabilizing the market and improving the well-being of the people. Due to the deterioration of Sino-Soviet relations, China's foreign trade rapidly shifted to the capitalist markets, both as an export destination and as a source of technology and equipment. However, owing to the economic difficulties during this period, for the first time China's foreign trade experienced a slump. Import and export volume in 1962 dropped by thirty percent from 1960, falling back approximately to the 1954 level. After 1963, with the readjustment of the national economy and the improvement in industrial and agricultural production, foreign trade achieved a significant recovery. From 1963 to 1966, trade volume increased at an average annual rate of 14.7 percent. In 1966 as a result of the catastrophic "Cultural Revolution" and the disruption and interference of the ultra-left line, China's foreign trade was again seriously damaged. Import and export volume in 1969 was 12.7 percent less than that of 1966. Due to the twists and turns of foreign trade, the average annual growth rate of trade volume during the 1960s was only 1.9 percent, lower than the growth of industrial and agricultural output during the same period.

After 1971, Premier Zhou Enlai devoted great efforts to developing foreign trade. As a result, imports increased considerably, and trade volume recovered fairly well by 1975. Because of the sabotage by the "Gang of Four," however, imports declined again thereafter, exports stagnated, and the development of foreign trade was damaged once more.

Since the Chinese government decision in 1978 to implement the policies of opening to the outside world and invigorating the domes-

tic economy, China has actively developed foreign economic co-operation and technological exchanges, and foreign trade has registered new development.

The government now regards the development of foreign economic relations and trade as a strategy for developing production and construction as a whole, accelerating economic development and increasing the capacity for self-reliance. China's development strategy now stresses the utilization of two types of resources (domestic and foreign), the development of two markets (domestic and foreign), and the learning of two skills (the ability to organize domestic construction and the ability to develop foreign economic relations). In the past China also attached importance to developing foreign trade, but it one-sidedly stressed the role of trade as a residual mechanism for achieving an overall adjustment of surplus and deficiency within the plan, rather than making full use of the international market to promote the development of the domestic economy. Undoubtedly, to carry out economic construction in such a large country as China, it is absolutely correct to pursue a policy of self-reliance. We must adhere to this policy but at the same time recognize that it is a mistake to neglect the contribution that foreign trade can make.

We have carried out the reform of the foreign trade system in various ways. Where conditions permit, production departments and localities now handle foreign trade directly; formerly the state foreign trade departments and enterprises monopolized foreign trade and marketing. Export-oriented enterprises are in a better position to organize production in accordance with international market needs and to increase the adaptability and competitiveness of export products. Because import and export business is directly linked to the economic benefits of the production departments and local enterprises, they show greater concern for developing foreign trade and adopt some measures on their own initiative to promote its development. By now, over one thousand enterprises have, to varying degrees, been given the authority to handle their own foreign trade.

More flexible and diverse foreign trade methods have been adopted to meet the international market demand. Besides carrying out trade in cash and on credit in accordance with normal international trade practice, China has developed such trade methods as processing of imported materials, compensation trade, and barter. China has begun to accept loans from foreign governments and international financial organizations and to absorb direct foreign investment by developing Sino-foreign co-operative production, joint ventures,

and wholly foreign-owned businesses. At the same time, we have also established various forms of enterprises abroad.

Important changes have taken place in China's foreign relations. As a result of the implementation of an independent foreign policy and the policy of opening to the outside world, our foreign economic relations have developed rapidly. With the establishment of diplomatic relations with Japan, the United States, and many other countries, and with the expansion of multilateral diplomatic activities, China's foreign trade has developed rapidly. Between 1976 and 1980, the nominal value of trade grew at an average annual rate of 29 percent. Even after correcting for price changes and the shift of the exchange rate, the real growth of exports was 13.7 percent per annum, a record level since the founding of the People's Republic. Since the beginning of the 1980's, China's foreign trade has continued to develop. The total import and export value doubled during the Sixth Five-Year Plan (1981-85), overfulfilling the planned target. China's share of world export volume increased from 0.92 percent in 1980 to 1.38 percent in 1986, thereby raising China from twenty-sixth rank to fifteenth among exporting countries.

Experience has proved that foreign trade is an important component of China's national economy. At the same time, foreign trade activities are important to the implementation of China's foreign policy, developing our foreign relations, strengthening our unity and co-operation with other Third World countries, opposing hegemony, and defending world peace. Foreign trade plays a positive role in the two fields—economic and diplomatic.

II. The Structure of China's Foreign Trade

Parallel to the changes in China's foreign relations and the development of our national economy, there have been great changes in the structure of foreign trade.

A. The Structure by Countries and Regions

The structure of a nation's trade with countries and regions depends primarily on its foreign relations. During the 1950s, when China was subjected to blockade and embargo, we maintained friendly relations with the Soviet Union and East European countries, which were also China's main trade partners. During the 1960s, after Sino-Soviet relations deteriorated, China's main trade shifted to the capitalist countries. During the 1970s, the establishment of diplomatic relations with Japan, Canada, the United States, and many other countries gave a big boost to foreign trade. But more importantly,

the increase in foreign trade was determined by the development of China's national economy—its needs and possibilities. For a long time in the past, China needed to import advanced technology, machinery and equipment, raw materials for industry, grain, cotton, sugar, and other farm products. These commodities were imported mainly from Europe, the United States, Japan and other developed countries. Thus China's imports from these countries were large, whereas our exports to them, due to various limitations, did not grow as fast. As a result, China suffered a long-term deficit. In the early 1980s, because China curtailed imports, our trade deficits with the developed countries decreased somewhat for a while. In the last few years, our import of farm products from abroad has decreased, but because the imports of various types of production lines, equipment, general machinery, electrical products, and consumer durables were not adequately controlled, China's trade deficits with the developed countries again expanded and our trade surplus with Hong Kong diminished.

Most years, the regions of Hong Kong and Macao have ranked first as a destination for China's exports. Because these regions are a part of China's territory, where over 98 percent of the population are compatriots, and because local stability and prosperity depend heavily on trade with China, exports to these areas are of particular significance. The mainland supplies mainly food, clothing, and other perishables and daily necessities, although in recent years exports of finished products have increased.

Of the developed countries, Japan is a particularly important trading partner, especially since the establishment of diplomatic relations in 1973. Trade with Japan now accounts for about one-fourth of China's total trade volume. However, exports (of which oil represents about 50 percent) have not balanced imports (of which steel is the most important commodity), and this bilateral deficit has persisted for many years. Trade with the United States was nonexistent before 1972, but reached US $7 billion in 1985, although again there is a serious and persistent deficit in this trade. In Western Europe, China's largest trade partner is the Federal Republic of Germany, while Britain, France, Italy, Switzerland, and the Netherlands are also important. China's main imports are advanced technology, equipment and machinery, rolled steel, and chemicals, while exports are mostly native products, foodstuffs, textiles and other light manufactures. Since about 1983, exports to Western Europe have stagnated while imports have increased, leading to a growing trade deficit. Trade with Canada and Australia has emphasized imports of grain and industrial raw materials and exports of textiles,

native products, and foodstuffs, also with substantial long-term deficits.

During the 1950s, trade with the Soviet Union and Eastern Europe occupied a dominant position, accounting for 76 percent of total trade in the peak year. In the 1960s, with the deterioration of Sino-Soviet relations, trade dropped sharply. However, since the beginning of the 1980s, trade with Eastern Europe has been largely rehabilitated, and trade with the Soviet Union has also developed fairly rapidly.

China is actively working to develop trade with the Third World, but results to date have been inadequate. Of the Association of South East Asian Nations (ASEAN) countries, China has formal diplomatic relations with Malaysia, Thailand, and the Philippines, and some direct trade has developed. Trade has also developed rapidly with Singapore, despite the absence of diplomatic ties. Of the oil-producing countries in the Middle East, China trades with Iran, Iraq, Saudi Arabia, Kuwait, Bahrain, Qatar, the United Arab Emirates, and Oman, but the volume of this trade has decreased somewhat in recent years. In Africa, where the volume of trade is quite small, China's major trading partners are Eqypt, the Sudan, Nigeria, and Algeria. In Latin America there is great market potential, but trade progress has been insignificant. Of China's exports to this region, Brazil absorbs about half (mainly oil), while Cuba—which provides trade credits to China—is also important.

B. The Commodity Composition of Imports

What Old China imported was mostly consumer goods. Since the founding of New China, the import of capital goods and raw materials has always enjoyed priority position, representing about 80 percent of total imports in most years.

During the 1950s, means of production dominated imports, reaching 91.5 percent, while consumer goods were only 8.5 percent of imports. Of the capital goods, complete sets of equipment and machinery accounted for a large proportion—51 percent of the total imports. During the First Five-Year Plan (1953-57), China imported 156 major industrial projects from the Soviet Union and 68 projects from the East European countries.

In the early 1960s, China suffered from serious economic difficulties. Therefore, we reduced the import of capital goods and raw materials while appropriately increasing the proportion of consumer goods. Imports of grain, sugar, animal and vegetable oil and other materials for the domestic markets increased considerably.

Later on, due to obstruction by the "Gang of Four," all import work was seriously hampered for some time.

During the 1970s, with the development of China's foreign relations and according to the requirements of the Fourth Five-Year Plan, import trade underwent a big development. In 1972 an import that had been suspended for many years was restored when China began to bring in complete sets of equipment and technology. However, as a result of interference and sabotage by the "Gang of Four," imports were again disrupted for several years. After the downfall of the "Gang of Four," and especially after 1978, imports have once more flourished. Overall, during the 1970s means of production accounted for 81 percent of total imports, while means of livelihood comprised 19 percent.

Since the beginning of the 1980s, with the rapid development of agricultural production, China's imports of grain, oil seeds, and cotton have gradually decreased; the imports of rolled steel, timber, non-ferrous metals, synthetic fibre, pulp, paper, chemical raw materials, and other industrial raw materials have remained important. The import of production technology and key equipment has increased. In 1985, means of production comprised 82.8 percent of total imports (of which machinery and equipment constituted 31.9 percent; industrial raw materials, 46.6 percent; and agricultural materials, 5.3 percent), and means of livelihood, 17.2 percent. In recent years, import of motor vehicles, household electrical appliances, and other consumer goods has increased rapidly. Continuing such an import structure over the long term is a problem that needs attention. In 1986 the import of high-grade consumer goods decreased, and the structure of import commodities is becoming more reasonable.

C. The Commodity Composition of Exports

Old China mainly exported agricultural and sideline products. Since the founding of the People's Republic, China has continued exporting traditional agricultural and sideline products. In addition, it has actively developed the export of processed products, particularly the export of textiles and light industrial goods. In 1978 China began to export more crude oil; the export of machinery and electric products has also increased but still remains a small proportion.

In the early 1950s, primary products comprised 80 percent of China's exports, and manufactured goods comprised about 20 percent. With the rehabilitation and development of the national economy, the mix of exports also underwent great changes. By 1965, the proportion of primary products in total exports dropped to 51.2

percent, while that of manufactured goods rose to 48.8 percent. Of the primary products, the proportion of foodstuffs did not experience much change, staying at about 30 percent, whereas the proportion of non-food raw materials shrank considerably, falling from 33 percent in 1953 to 15 percent in 1965. Of the manufactured goods, textiles and light industrial goods increased dramatically, jumping from 12 percent in 1953 to 31 percent in 1965. The export of textiles, in particular, grew rapidly, soaring from 5.3 percent of total exports in 1953 to 20.5 percent in 1965.

After 1978, although exports grew rather fast, the export composition, in terms of the two broad categories of primary products and manufactured goods, did not change much. Roughly speaking, each category accounted for 50 percent. However, within these broad categories, major shifts occurred. Within exports of primary products, the proportion of foodstuffs dropped noticeably, falling from 31 percent in 1965 to 16.1 percent in 1985; non-edible raw materials also slid from 15 percent to 9.2 percent. Minerals and fuel increased dramatically, because of oil exports. In 1985 the export of mineral fuel made up 28.3 percent of total exports. Within exports of manufactured goods, the proportion of textiles and light industrial goods remained at about 32 percent, whereas the proportion of heavy and chemical industrial products increased to 13.9 percent in 1985, of which machinery, electric products and transport equipment rose from 3 percent in the past to 8.5 percent in 1985.

The change in export composition parallels the development of the national economy. Since 1949, the proportion of traditional agricultural products (mainly foodstuffs and raw materials) in total exports dropped sharply year by year. The export of oil products and manufactured goods registered a fairly big increase; of the latter the export of textiles and light industrial goods, mostly labour-intensive products, assumed a big proportion. The export of heavy industrial goods had a sluggish growth. This shows that the composition of exports still remains to be improved.

III. Foreign Trade Tasks for the Seventh Five-Year Plan

The Seventh Five-Year Plan will be a decisive period for China's economic development as well as a period during which a foundation will be laid for rejuvenating the economy in the 1990s. To meet the needs of the state's production and construction during the Seventh Five-Year Plan and in line with the principles of independence, equality, and mutual benefit, we will further strengthen economic and trade contacts and technological exchanges with

various countries around the world, including the developed and developing countries, to make sure that by 1990 our import and export volume will increase by 40-50 percent over that of 1985.

The key to developing foreign trade lies in actively increasing our ability to earn foreign exchange through export. Only by expanding exports is it possible to ensure we will be able to import significant materials needed by the state, achieve a satisfactory balance of payments, and guarantee the smooth expansion of foreign trade work.

In order to develop exports, it is very important to change the composition of export commodities. During the Seventh Five-Year Plan, efforts should be made to bring about two changes: one is changing from exporting mainly primary products of a raw materials nature to exporting primarily manufactured goods; the other is changing from exporting coarsely processed products to exporting finely processed products. For this, the state will energetically support and develop the production of export commodities, utilize foreign capital, import technology, give priority to strengthening the technical reform of export-oriented enterprises, stress improving the quality of export products, and constantly develop new variety so as to meet the needs of the developing international market.

Japan in the 1960s faced the same situation as China does today: economic development required importing in large quantities. Japan lacked foreign exchange. Therefore, it concentrated its efforts on studying how to expand exports. As a result, its exports developed and it achieved a trade surplus. This experience merits our attention.

According to the experience of various countries, a country's foreign exchange reserves should be kept roughly at a level adequate to pay for three months' imports. A large country, such as China, should have even more foreign exchange reserves, so as to satisfy its needs in various fields. At the same time, the amount of foreign exchange reserves reflects upon the country's reputation and directly affects China's foreign economic relations and trade activities and the smooth implementation of the policy of opening to the outside world. As a developing country, China will lack foreign exchange for many years to come; we must be mentally prepared for this. Because more than 80 percent of China's foreign exchange comes from merchandise exports and less than 20 percent comes from invisibles—such as shipping, tourism, and labour service—the key to solving our foreign exchange problem lies in expanding exports. During the Seventh Five-Year Plan exports will emphasize the consolidation and development of traditional farm, sideline, and native products; the expansion of oil, coal, metals, and other natural

resources (though this will be constrained by domestic energy needs and the inadequacies of transportation and port infrastructure); the continued importance of textiles and other light industrial products, with greater attention to improving quality and increasing value added; and a significant effort to expand exports of machinery and electrical products.

While it is important to develop exports, imports are also an indispensable component of foreign trade; the ultimate aim of earning foreign exchange through exports is to guarantee the import of materials essential for national construction. Furthermore, a country's expansion of imports can boost exports. During the Seventh Five-Year Plan, the national economy will maintain a certain speed of development, and the country will concentrate its efforts to build a number of key projects for energy, communications, telecommunications, and raw material industries. Technical transformation of existing enterprises will be stepped up; we expect that the import of new technology and key equipment will increase. Although China is rich in natural resources, some resources remain to be exploited. Calculated on a per-capita basis, the country's resources are still not adequate. As domestic production develops, we should gradually curtail some imports of raw materials. However, in order to ensure the needs of economic development, we need to continue organizing a certain number of imports, such as the import of rolled steel, chemical fertilizers, chemicals, chemical fibre, timber, and other commodities. We also need to import some grain. China will limit the import of ordinary consumer goods, but we will still need to import a small number of commodities urgently needed on the domestic market.

Foreign trade methods will become more flexible. Apart from trade for cash and on credit carried out according to international practice, China will continue to adopt such trade methods as the processing of imported materials and compensation trade. To meet the requirements of the developing countries, China has begun to pay attention to the use of reciprocal trade and barter. We will make active efforts to carry out such trade in a planned and systematic way.

IV. Major Measures for Developing Foreign Trade

In order to develop foreign trade and fulfill the tasks set for the Seventh Five-Year Plan, we must adopt effective measures:

(1) In our policies, China should regard the development of foreign trade and the expansion of exports as a strategic problem

involving the whole situation of production and construction. Developing foreign trade is not a matter solely for the foreign trade departments, but a task for the whole country. Foreign trade is not a matter that we can take or leave, that we can emphasize or neglect, as we please.

(2) We should conscientiously draw up plans for the development of export commodities. For this purpose, we need to thoroughly investigate the development trends of the international market. As changes occur in domestic and international markets, some commodities may not have a bright future for development or may even have to be eliminated. Other commodities may undergo great development. China should pay special attention to studying the development of new commodities and to making them competitive.

(3) We must establish and develop the export commodity production system and ensure the production of large numbers of superior-quality products that suit the needs of foreign customers. China's domestic market is very large, and at present we are not in a position to raise all products up to the standards required of exports. In line with the development plan for export, departments of foreign trade, production, scientific research, and service should closely coordinate with one another. The best export production bases and specialized factories should be selected for the production of export commodities, and the state should give them active support. Export-oriented enterprises should enjoy priority in the use of foreign capital and the import of advanced technology.

(4) We need to change the composition of import and export trade. At present, the mix of import commodities is not reasonable. We should bring under strict control the import of general consumer goods; where conditions permit the production of raw materials, we should make active efforts to gradually substitute domestic supplies for imports. So as to gradually reduce imports, we should as quickly as possible produce at home the components and parts assembled by various production lines. China should place the emphasis of imports first on advanced technology and key equipment, especially technology and equipment needed for technical transformation and the expansion of exports. We need to consolidate and develop the export of traditional farm, sideline, native, and special products and to continue to develop the production of oil and coal. We should continue to export both oil and coal, as well as metals. Regarding textiles and light industrial goods, our main task is to improve quality and increase value added; we should make greater efforts to develop the export of machinery and electric products. We need to stabilize exports to the regions of Hong Kong and Macao, and to

consolidate and develop the markets in Japan, Western Europe, and the United States and Canada, so as to reduce China's trade deficits. We should restore trade with the Soviet Union and Eastern Europe. China should make great efforts to open up markets in Latin America, Africa, and the Gulf countries, to increase imports, expand exports, and develop South-South co-operation.

(5) Industry and trade should be closely integrated, and concerted efforts should be made to develop production, expand sales and increase exports. In reforming the foreign trade system, we need to separate government administration from enterprise management, infuse added vitality into foreign trade organizations and productive enterprises, energetically develop the production of export commodities, improve the quality of export commodities, reduce production costs, make use of foreign sales networks, fully utilize the selling power of foreign clients, and organize powerful sales networks according to different commodities. At present, China has many dealings with medium and small clients but few ties with large, transnational companies. We need to study how to open up more channels in this regard, to give publicity to China's products, conduct market investigations and develop services before and after sales.

(6) At present, the developing countries are short of foreign exchange, and they have difficulties in paying for imports with cash, so they generally adopt barter methods. At present, barter trade accounts for about 10 percent of the world's total trade volume; in the future, this figure may possibly increase to 30-40 percent. The developed countries, in their trade with the developing countries, also adopt the barter method at times. On the premise that the state plan is fulfilled, we must consider actively developing this business.

(7) We must strengthen intelligence, information, and research into the international market. Under current circumstances—when the new technological revolution is developing, the world economy is being readjusted, financial markets and currencies are oscillating and the international market is always changing—it is of special importance for us to strengthen our knowledge of the international market. Information technology has become an important factor in international market competition. Where conditions permit, we need to set up specialized intelligence, information, and research institutions, to assign an adequate number of personnel to them, and to give active support to their role. The leading bodies at all levels should stress investigation and study and, in accordance with the change in the international market and the needs of the development of foreign trade, conduct special studies of strategy and tactics in a

planned and organized way, reduce blindness in various businesses, increase initiative, improve administrative and management skills and expand economic results.

(8) We need energetically to train foreign economic and trade personnel, improving the quality of the workers and staff members so as to meet the needs of foreign economic relations and trade. The current outstanding problem is the lack of personnel who can directly engage in foreign trade. Many cadres lack knowledge of international trade and international finance; their foreign language level is low; and their practical experience is inadequate. There are even fewer people who know foreign economic laws. Therefore, from now on we must take the training of personnel as an important task. Apart from establishing and expanding the economic and trade colleges and universities in various places, we should, through various channels and by adopting various methods, conduct on-the-job training, and encourage local authorities to sponsor lectures and run medium- and short-term specialized training classes. We should invite foreign experts to visit, and we should send Chinese personnel abroad to receive training. We should see to it that during the Seventh Five-Year Plan the professional level of the personnel engaging in foreign trade will be raised considerably and more cadres will be able to handle foreign business proficiently and independently.

As long as we bring about better balanced relations, closely integrate industry with trade, and work out proper policies and measures, China's foreign trade will be able to develop rapidly. It is estimated that by 1990 world export trade volume will exceed US $2,500 billion, the share and rank of China's exports in the world total will be further raised, and China will be in a leading position among the developing countries and regions.

Through work done during the Seventh Five-Year Plan, the commodity structure of imports and exports will gradually become more reasonable, markets will be expanded, the foreign trade system will be more thoroughly reformed, and foreign trade legislation will be much improved, thus laying a foundation for economic rejuvenation and still greater development of foreign trade in the 1990s.

The position and role of foreign trade in the national economy will be further strengthened. With improvement in administration and management, the various economic results will be improved. Through improving the quality of products, the same quantity of export commodities can earn more foreign exchange and accumulate more funds for the state.

With the development of foreign trade and the strengthening of foreign contact, economic and trade relations between China and other countries will, on the basis of equality and mutual benefit, be further developed. This will play a still greater role in developing South-South* co-operation, expanding trade between East and West, and defending world peace.

* In this context, "South" is shorthand for "developing countries" or "low-income countries."

I
China's Global Trade Picture

2

The Role of Trade in China's Development Strategy

Wu Jikun

Today, the world economy has entered an historical period of great changes. The vigorous development of the new technological revolution and the regulation of national economic policies and structures in various countries are forming a mighty torrent to bring profound changes to the world economy.

After the prolonged stagflation in the 1970s, the developed countries are sparing no effort to adjust their economic and industrial policies. The new technological revolution broke out in these countries, and a series of most up-to-date technologies has been adopted in production. It is obvious that these technological innovations are not going to eradicate the fundamental contradictions of capitalism, but they will undoubtedly alleviate the contradictions and give new momentum to economic development. The industrialized countries will shift their economies from the high-speed developing "quantitative" type of the 1950s and 1960s to the "qualitative" type, which focuses on quality and efficiency. This change of policy has been marked by the continuous drop of the prices of primary products in recent years. In addition, service trades have expanded rapidly while the manufacturing industries have shrunk. Liquid capital, as distinct from industrial capital, has become an important means for amassing wealth.

The emerging industrialized countries (regions) from among developing countries are intensifying their economic strength. Their ranks keep expanding too. By relying on solid industrial and technological foundations, absorbing advanced technologies, and making use of the opportune moment when developed countries are refashioning their industrial structures, the newly industrialized countries (NICs) focus on production of high-technology products and on modernization of their economy, utilizing to the full their own favourable conditions. It is possible for a few of them to join the ranks of developed countries by the end of the century. However, most of the developing countries will continue to face the heavy burden of depressed primary product prices and foreign debts. The economic gap between the developed and the developing will be further enlarged.

The reform of economic structures is now underway in the USSR and East European countries. Reform and an open policy are the

inevitable trend. Their reforms are restricted by conflicting factors, but the pressure created by slow growth and prolonged imbalance in the past will continue to add momentum to these reforms.

The door of world economic relations and trade opens wider and wider, while the international division of labour deepens. All nations, whether developed or developing, and regardless of their social systems, will be deeply involved in this international network. The tendency is for the internationalization of economic activity, production, and capital. The proportion of technology trade and services in international economic interflows will increase. In commodity trade, the life cycle of commodities is growing ever shorter. The competitiveness of a commodity is now largely decided by its intellectual content, and price differences have been relegated to second place. Consequently, it becomes difficult for developing countries to maintain one of their major advantages—their low-cost labour. Price differences between manufactured goods, especially high-grade goods, and primary products will grow, thus worsening the terms of trade for developing countries.

Guided by the correct policies of activating the domestic economy and opening to the outside world, China's economy has made rapid, all-round progress. The successful reform of agriculture has been followed by reforms of the economic structure in urban areas. A new model of socialist commodity economy is coming into being, and the vitality of the national economy has been greatly strengthened. During the Sixth Five-Year Plan (1981-1985), the gross national product increased by an average of 10 percent annually, a rare achievement by world standards. China's commodity trade (that is, imports and exports together) totalled US $229.4 billion between 1981 and 1985, doubling that of the previous five-year period. Trade in 1986 stood at US $60.7 billion. Foreign investment in China has also increased many-fold. During the Seventh Five-Year Plan (1986-90), foreign trade volume will grow by about 40 percent, or US $83 billion, while foreign investment will increase significantly. Foreign trade and economic relations have become a pillar of China's economic construction.

However, fresh challenges to the open Chinese economy will come from changes in the international economic environment. We can never be satisfied with what we have achieved. Compared with other national economies, China is relatively backward, and it will be an extremely arduous task to make a country as big as China into an industrialized nation. Therefore, it is important for us to brace up and meet the changing world economy. First of all, it is an urgent task for China's foreign trade departments, which participate directly

in international transactions, to increase their ability to meet the changes. In my personal view, we face serious challenges in five areas:

(1) Upgrading of import substitutes: After the establishment of the People's Republic of China, a policy of national industrialization through import substitution was followed. Heavy industry, equipped with imported machines, turned out products that would otherwise have been imported. This type of development model was necessary at the time, and over the past four decades a solid foundation was laid for the self-reliant development of the national economy.

However, China cannot keep always to this type of development. Designed chiefly to satisfy domestic needs, it is deprived of international competition and leads to a closed economic cycle that hinders economic progress. Many countries have shifted from manufacturing import substitutes to producing export goods, enabling the economy to develop quickly on a higher level.

China's productivity remains low, hardly able to meet domestic needs. Our country is still unable to free itself from an "economy of need" (that is, an economy with a preponderance of sellers' markets), and its products lack competitiveness on the international market. Therefore, conditions are not yet ripe for China to switch completely to an export-oriented economy. But China boasts a good industrial foundation, proficient technical forces, and the ability to assimilate foreign technologies. Consequently, we shall lose no time in upgrading import substitutes. That is, we shall focus our imports on know-how, software, and key equipment, instead of complete sets of equipment and raw and processed materials. This elevation of import replacements is aimed at pushing the introduction of advanced technical know-how to increase export. It combines imported and domestic technologies and equipment to form a productive force that is capable of assimilating foreign technology with creativity. Production will not simply be limited to import substitutes. Product quantity and quality can be raised and variety increased. In addition, the upgrading will promote domestic technical progress in producing subsidiary equipment and components. In this way, China's technology and production systems will develop in full, to provide a solid material and technical basis for raising export commodities to a higher level, refashioning their structure, and expanding export trade.

(2) Vigorously shifting to export-led growth: Exports constitute the material basis of China's foreign economic activities. The expansion of exports, increase of foreign exchange earnings, and

promotion of payment ability will remain prominent tasks for many years to come. The upgrading of import substitutes will be out of the question if China's payment ability is low. While continuing the development of traditional export items, we must produce a greater proportion of manufactured goods, especially intensively processed articles, to earn more foreign exchange.

However, foreign exchange is not the ultimate aim of China's foreign trade development strategy. Several developing countries have enjoyed enormous foreign exchange earnings, yet their single-product economy remains undeveloped, without any changes in industrial structure. China's export economy must be combined into the overall strategy of the nation's economic and technological development, to be developed and used as a part of the organic whole. China's aim is to enter the international division of labour through export trade, so that enterprises will face the pressure of international competition and refashion their technology accordingly. In order to attain such good results, China's national economy must be transformed into an open economy dominated by export trade.

Such transformation calls for a prolonged transitional period. Vast disequilibrium in economic development exists between the coastal regions and the hinterland, and even between the various provinces in the hinterland. The distribution of natural resources is also uneven. Therefore, the transition to an export-oriented economy must be completed step by step and at different levels. At present, China's Special Economic Zones, open coastal cities and development areas have gained significant results in economic construction. Horizontal economic ties have now been developed between enterprises that used to be controlled vertically by the ministries. These new developments have provided favourable conditions for the coastal regions to take the lead in building an open economy with export trade as the dominant sector. The Seventh Five-Year Plan stipulates that an export-oriented economy shall be formed in the four Special Economic Zones, with powerful industries and advanced technology. Other coastal cities and regions shall follow suit when the time is ripe. Facing the international market, these regions form a ring along the southeast. They will become China's first industrialized region to be equipped with advanced technology and will gradually bring economic and technological development to the hinterland.

(3) Putting foreign investment and imported technology to full use: Foreign funds and technologies are important for China's modernization. Good results have been made in this regard since

1978. By the end of 1986, foreign investment reached a total of US $28.9 billion, and 8,189 Chinese-foreign joint ventures of all types had been approved by the Chinese government. Foreign funds are an important source of capital, but they also bring new technology and advanced management experience, playing a positive role in China's modernization construction. While encouraging the expanded use of foreign capital and technology, however, we must also pay close attention to economic results.

During the Seventh Five-Year Plan, the emphasis of foreign funds and technology will be on: first, energy, communications, transport, and raw and semi-finished materials, especially electricity, ports, and petroleum industry, and other infrastructure and basic industries. Second, updating of old enterprises, especially those enterprises that produce export commodities and import substitutes. Third, developing new industries, for instance computers, new materials, and new types of energy. Technology that can be produced in China will not be imported, in order to protect the national industries and the development of domestic technology. Assembly-production lines to produce goods for the domestic market, which bring no advanced technology and earn no foreign exchange, will no longer be imported.

Good economic returns are judged by: first, the time needed to upgrade the specific enterprise and improve short-term economic performance. Second, the economic result of the whole industry after assimilation and dissemination (excluding those technologies protected by the patent law). Third, the socio-economic effect produced on China's own technological system by merging with foreign technology. Consequently, assimilation and development are the key to securing maximum economic results from the introduction of foreign capital and technology. It goes without saying that introduction without assimilation can produce no good results. It can only lead to repeated importation. On the other hand, introduction without creative development can only follow others' footsteps. The technological gap will always remain. The maximum economic performance can only be obtained through the establishment of an effective "assimilation and development system" to enable China to join the ranks of advanced countries.

With the international market as the target, more foreign funds and technologies will be used to equip factories that earn foreign exchange, work with high efficiency, and manage to have a quick turnover. These resources will also be used on construction of export commodity production centres and on formation of export commodity production systems. Efforts will be made to upgrade export commodities and to export more manufactured goods in place of

primary goods. At the same time, foreign capital and technology will also be used to produce import substitutes, especially in those industries that are auxiliary to export production, so that a dual purpose can be served—import substitution and promotion of exports.

(4) Expanding trade in services ("invisibles"): China's tertiary industry, compared with most countries, is underdeveloped. Receipts and payments of invisible trade occupy a negligible share of China's balance of payments. The major industries involved include only service exportation, foreign engineering, project contracting, tourism, and ocean shipping. Financial services, insurance, consulting work, and software are only in their initial stage of development. However, China's resources for tertiary industry—especially labour and tourism—are plentiful and will be fully tapped.

Between 1978 and 1985 China signed project engineering contracts worth US $5.1 billion with more than eighty countries and regions. Of these, some US $2.4 billion worth of contracts have been executed by 170,000 engineers and technicians working abroad under fifty specialized labour service corporations. This achievement is outstanding compared with what China had done in earlier years. But it is insignificant in the world context. For instance, the world's total volume of contracted projects in 1984 came to US $80 billion, but China captured only 2 percent. Close to ten million people were sent to work in other countries, but Chinese personnel accounted for a mere 0.6 percent. China is technically qualified to secure more contracts, but the international competition is fierce, and the market is depressed. Simple labour exports are no longer feasible. Consequently, projects must be combined with trade to boost the export of materials, equipment, and other services. Generally speaking, the cost of material and equipment occupies 50 percent of the total cost of an international contractual project, but it is much lower in a Chinese contracted project. This percentage must be raised. In addition to supplying common services, China must provide intellectual services, such as project designing, consulting, and software exports. When appropriate, China's foreign contractual projects and labour services must also be combined with financial and banking services.

Tourism is to be developed extensively. China's rich tourism resources have not been fully developed. The central point is to intensify construction of tourist facilities and to train more tourist guides, so that this smokeless industry can be used to increase foreign exchange earnings.

Other invisible exports, including financial services, insurance and shipping, must also be actively developed.

(5) Using macro-economic levers to accelerate trade: Almost every country uses macro-economic levers to boost foreign trade. These administrative measures have been adopted by both developed and developing countries, and it is most important for China to do the same. China's vast domestic market can be characterized as an "economy of need." This kind of seller's market provides no pressure on the enterprises whose products lack international competitiveness, especially when internal profits are greater than external profits because local prices are higher than those on world markets. This is why economic levers should be used to stimulate exports. Preferential policies and measures have been developed in taxation, credit, export promotion, and fuel and raw material supplies. They are playing a positive role in supporting the development of export trade. However, these policies are implemented by separate departments and need to be co-ordinated by the government, so that all economic levers can be used in a comprehensive way. The government should make medium and long-range international market forecasts, map out strategies for commodity exports and market development, and decide on the kinds of articles to be developed as major export items in the coming seven to fifteen years. For instance, the mechanical and electrical products industry needs a long-term development plan. Consequently, the government has to formulate policies to enable it to enter the international market step by step.

3

Macro-Control of Foreign Exchange

Han Kexin

This article will discuss questions concerning macro-control of foreign exchange in China under the following four headings: goals, policies, problems, and institutions.

I. Goals

In terms of the reform of China's socialist economic structure, macro-control of foreign exchange has three goals. First, through macro-control of foreign exchange China hopes to improve its socialist economic plan, making it more flexible and more adaptable to changes in international economic conditions. Since the plan has few connections with monetary policies, of which foreign exchange policy is one component, the adoption of the policy on macro-control of foreign exchange will therefore help strengthen relations between monetary policy and the plan.

Second, macro-control of foreign exchange is geared mainly to maintaining a balance in China's international payments. Accumulating foreign exchange reserves is not the aim of balance of payments policy, nor is overspending of foreign exchange the aim of foreign trade. Under certain conditions, the balance of payments may be in surplus or deficit for a time, but the long-term aim of policy should be to achieve overall balance in the international payments.

Third, although the tactical goal is to maintain a satisfactory balance of international payments, the more important strategic target is to promote development of the national economy as a whole. When the international payments stay in surplus or deficit for a long period of time or huge sums are involved, such an imbalance adversely affects economic development.

To sum up, the aim of macro-control of foreign exchange in a socialist country is still, through foreign exchange policy, to perfect the state's economic plan, give scope to the market mechanism, and develop the national economy as a whole.

II. Policies

To achieve the above goals, we must formulate and implement concrete policies and measures. To do this work well, we must understand several points. First, the countries of the world are

economically interdependent. Foreign economic conditions exert great influence on China's economy, while China's foreign exchange policy in turn affects the international economy. This mutual influence will become greater as the volume of trade grows.

Second, although macro-control of foreign exchange deals directly with foreign exchange income and expenditure, it is closely related to the domestic currency as well. Therefore, it will have a direct impact on all monetary phenomena, including the interest rate, exchange rate, credit, and money supply. It will also affect domestic economic phenomena including commodity prices, production, employment, and government finance. In a nutshell, the policy on macro-control of foreign exchange will influence the readjustment of all economic sectors.

Third, given the intricate relationship between the macro-control of foreign exchange and the domestic economic sectors, to attain the goals of macro-control of foreign exchange it will not be sufficient just to carry out the foreign exchange policy. A number of complementary policies and measures will also be required on the domestic side.

With the foregoing points in mind, we can now discuss the two aspects of foreign exchange policy: the current account and the capital account.

A. The Balance on Current Account

The current account is that part of a country's balance of international payments which represents real income and expenditure. Of the current account, the most important component is the income from exports and expenditures on imports. .

As we know, the gross national product (Y) of a country is the sum total of domestic private consumption (C), government expenditure (G) and domestic accumulation or investment (I), plus exports (X) minus imports (M). That is:

$$Y = C + G + I + X - M \quad \ldots\ldots (1)$$

Here (X – M) represents the trade balance. When X is larger than M, it is a favourable balance; when X is smaller than M, it is an unfavourable balance. We use NX to represent the trade balance, i.e., NX = X – M. Then

$$NX = Y - C - G - I \quad \ldots\ldots (2)$$

Many factors, such as gross national product (Y), the exchange rate (e), commodity prices abroad (P'), and commodity prices at home (P), all combine to determine the trade balance. This is shown in the following formula:

$$NX = NX(Y, e, P, P', \ldots) \quad \ldots\ldots (3)$$

This formula shows that the trade balance can be affected by all of these factors, which means that policies shaping these variables must be considered accordingly.

These complex interrelationships are often presented graphically in an "IS-LM diagram," like Figure 3.1 (page 28). In this diagram. the IS line represents the various combinations of interest rate and GNP at which commodity markets will be in equilibrium (with aggregate supply equal to aggregate demand), while the LM line represents the various combinations of interest rate and GNP at which the supply and demand for money will be balanced. Thus, neglecting other influences for the moment, the economy shown in Figure 3.1 will tend to operate at an interest rate of about 10 percent and a GNP of about $200 billion (which may or may not be satisfactory in terms of full employment).

The situation with regard to the current account in the balance of payments (that is, imports and exports) is represented by the NX line. Initially, because we are disregarding the capital account, we draw NX as a vertical line. It may or may not pass through the intersection of the IS and LM curves. Along the NX line, imports balance exports, so there is neither a surplus nor a deficit on current account. Because imports (of both consumer goods and industrial raw materials) tend to increase as GNP goes up, the area to the right of the NX line is the region of current account deficits, while the area to the left is the region of current account surpluses.

If the NX line happens to pass through the intersection of the IS and LM curves (and if this level of GNP represents full employment), then the domestic economy and the foreign trade sector are both in balance and there is no need for adjustment. The only task for the macro-control of foreign exchange in these favourable circumstances would be to continue existing policies generally, and to reduce the foreign exchange reserves to the lowest level possible, lest there be idle capital.

The economy shown in Figure 3.1 is not so lucky. At the equilibrium level of GNP $200 billion, the current account would run chronic deficits. Since $NX = NX(Y, e, P, P')$, adjustment could be attempted in several ways. For example, if domestic prices (P) can be lowered relative to foreign prices (P'), by reducing costs of production, then exports will become more competitive on world markets (and imports less attractive), and the current account deficit can be cured. (Graphically, the NX line shifts to the right.) However, attempts to reduce domestic costs of production are fraught with difficulty. Therefore, macro-control of foreign exchange—i.e., changing the exchange rate (e)—is generally more effective. The prices of

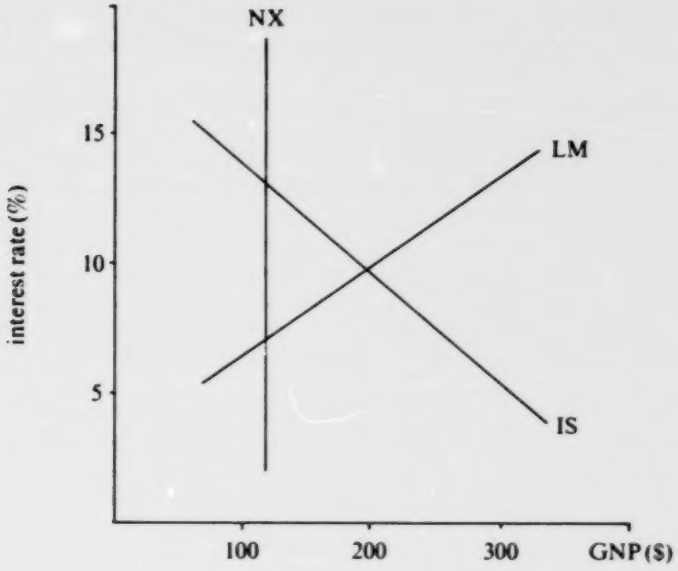


Figure 3.1

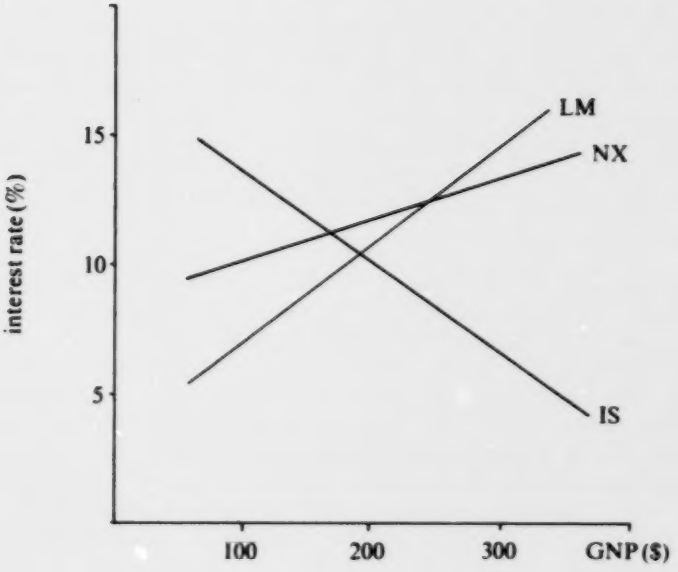


Figure 3.2

domestic products measured in foreign currency will drop, fueling an increase of overseas demand. At the same time, the devaluation will make imports more expensive and cause a sharp drop in demand of imports. This will quickly cause an increase of exports and decrease of imports, with the NX line again shifting to the right in the diagram.

However, a devaluation of the exchange rate will eventually cause a rise in domestic price levels. Therefore, adopting only the macro-control measure of exchange rate devaluation is effective for balancing the current account, but is not enough for the balanced development of the national economy as a whole. There must also be appropriately tightened fiscal or monetary policies to prevent inflation.

B. The Balance on Capital Account

In international payments, not only the current account but also the capital account must be balanced. The current account occupies the most important position in the international payments, but when it is not balanced in spite of various kinds of policies for the macro-control of foreign exchange, capital flows will emerge as an important part of the balancing mechanism. This is particularly true with the developing countries where, due to weak export ability and strong demand for imports, the current account can hardly be balanced. The inflow of capital becomes the most important means for achieving an overall balance of international payments, while stimulating the inflow of capital becomes the major task of macro-control of foreign exchange.

The capital account includes the inflow and outflow of all long- and short-term capital—for example, obtaining and repaying a loan, making capital investment and withdrawing the investment made, buying and selling securities, and supplying and repaying export credit. A country's foreign exchange reserves increase when the overall international balance is in surplus, and decrease when it is in deficit. They can be regarded as short-term working capital.

An important factor affecting the inflows and outflows on capital account is the interest rate. When the domestic interest rate (i) is higher than the overseas one (i'), there will be an inflow of capital, and conversely. Thus the balance on capital account (CF) can be represented like this:

$$CF = CF(i, i') \quad \ldots\ldots (4)$$

Once we include the capital account in our discussion, we must reconsider the NX line in Figure 3.1, for this line is no longer vertical when the capital account and current account are considered to-

gether. Rather, the NX line slopes, as in Figure 3.2 (page 28), reflecting the fact that at high domestic interest rates the capital account will be in surplus, thus offsetting the deficit on current account that usually accompanies a high level of GNP. Similarly, at low interest rates and a low level of GNP, a surplus on current account tends to offset a deficit on capital account. Thus, all along the NX line of Figure 3.2, there is an overall balance in the country's international payments.

In Figure 3.2, as in Figure 3.1, the country's economy will tend to operate at an interest rate of 10 percent and a GNP of $200 billion, with a chronic deficit in the overall international balance. As before, one possible corrective measure is to devalue the exchange rate (e) to improve the current account, but now another possibility is to raise domestic interest rates (i) so as to encourage a capital inflow and improve the capital account.

III. Problems

At present, several major problems exist in China's macro-control of foreign exchange.

A. Absence of Unified Policy

From the general principles expounded above, we see that one policy instrument alone will generally not work to attain the goal of macro-control of foreign exchange. Under most circumstances, there must be co-ordination of domestic monetary and fiscal policies, and generally there must also be co-ordination of production and commodity pricing policy. At the same time, the implementation of a particular policy of macro-control of foreign exchange will influence not only the international payments, but various domestic economic sectors as well. This points to the necessity of unified and co-ordinated policies. The People's Bank of China should be charged with this unification and co-ordination work. As the banking system has just undergone reform, however, there are still many problems with regard to unifying the policy of macro-control of foreign exchange. Therefore, perfecting the Chinese central banking system is a prerequisite for effective macro-control of foreign exchange.

B. Capital Flowing Out

In opening to the outside world, China aims to introduce overseas capital and advanced technology and equipment. The aim of China's policy of macro-control of foreign exchange should therefore be to increase the inflow of capital and promote the introduction of

foreign advanced technology and equipment. Therefore, there should be a favourable balance of the capital account and an unfavourable balance of the current account. From 1982 to 1984 China's international payments had a cumulative surplus of US $11.9 billion, of which US $6.2 billion was from merchandise trade; the capital account had an unfavourable balance of US $0.9 billion. Consequently, China's foreign exchange reserves increased by US $10 billion in those three years. The result was that China, which wanted to follow the policy of introducing foreign capital and advanced technology and equipment, was in fact a capital-exporting nation with a huge surplus on current account. This is the opposite of what China's macro-control of foreign exchange aims to achieve.

If we make a further analysis of the long- and short-term capital, the problem is even more glaring. Between 1982 and 1984, nearly US $10 billion of long-term capital flowed out, although most of this was offset by long-term inflows. In the case of short-term capital, although about US $0.5 billion flowed in, about US $1.7 billion flowed out. This made China a capital exporter instead of a capital importer. Short-term capital mostly took the form of export credit or payment on deferred terms. Why should China become a credit-grantor in trade payment?

C. Excess Foreign Exchange Reserves

As we know, the ratio of foreign exchange reserves to the value of imports is the usual standard applied to assess the adequacy of reserves, because a country pays to foreign countries for what it has imported, and the foreign exchange reserves should stay at a level sufficient to pay for a certain amount of imports. Although there is no iron-clad rule with regard to the appropriate level of foreign exchange reserves, generally they should make up 20-30 percent of annual import volume. Following are the levels of foreign exchange reserves of three groups of countries in the world:

Countries or regions	*Percentage of foreign exchange reserves in annual import value*
Japan, France, Federal Republic of Germany, the Netherlands	15-28
Singapore, Malaysia, the Philippines, South Korea	27-35
Hungary, Romania Yugoslavia	3.5-18

The levels of foreign exchange reserves of the above countries are fairly representative. In accordance with the general international level and the level of Chinese imports, China needs to have about US $8-10 billion of foreign exchange reserves. Amounts in excess of this level would mean "overstocking" of capital. Surplus reserves should be used to buy foreign advanced production technology and equipment, which complies with the need of macro-control of foreign exchange.

IV. Key Institutions

What are the macro-control institutions that can put appropriate policies into practice and solve the existing problems? The answer has two parts: first, China must set up a central banking system with authority over macro-control work, and second, we must deregulate part of the foreign exchange market.

The ultimate target of China's current socialist economic reform is the establishment and development of a planned commodity economic system. The planned commodity economy calls for planned macro-control at the central level with micro market economic regulation. In the field of foreign exchange, there should be a central banking system capable of exercising effective macro-control of foreign exchange as well as a foreign exchange market which can play the role of micro regulation. Both of them are indispensable. The macro-control by the central banking system is planned economy in nature, while the influence of the foreign exchange market is commodity economy in nature. Only by integrating the two can there be effective macro-control of foreign exchange under the planned commodity economic system.

China has made the first step towards the establishment of a central banking system. The Chinese government has designated the People's Bank of China the central bank of China. But we still have to do a lot of work before we can set up a central banking system which is authoritative and effective. First, we must assure that the central bank has appropriate authority in law. To put the policies concerning macro-control of foreign exchange into practice, the central bank must be able to enforce various kinds of monetary policies independently, free from any administrative interference and financial constraint. To this end, the central bank must be given power based in law, instead of administrative power only. The highest organ of power in China—the National People's Congress—should enact a law on the central banking system or a law on reforming socialist banks. This law should enable the central bank,

in accordance with the Chinese international payments and domestic economic conditions, to carry out policies concerning money supply, capital circulation, increase or decrease of foreign exchange reserves, market activities, exchange rate, and interest rate in a co-ordinated way to get the result of macro-control and micro deregulation.

Second, we must have a central banking system which is really unified vertically and associated horizontally. At present, the People's Bank of China, which functions as the central bank, is not up to its responsibilities. Organizationally, it has a head office only; the organization and functions of its local branches are not clear. Thus it is hard for the macro-control policies of the head office to be carried out. With regard to its horizontal association, the central bank lacks certain legal controls over the commercial banks, a fact of special importance today since the commercial banks are increasing in number. Some old commercial banks enjoy good reputations; due to traditional business relations, most of them are reluctant to accept guidance from the central bank. Some newly established commercial banks have also not established their legal relationship with the central bank. This is why complicated contradictions exist between the central bank and the commercial banks and even between the commercial banks themselves. If questions concerning vertical organization and horizontal association are not solved, the formation of an effective central banking system will not be possible, nor will there be macro-control of foreign exchange.

China is still considering the question of opening the foreign exchange market. But during China's current reform of the financial system, it has already been proposed that the financial or monetary market be opened up. And a capital market has been in trial operation in some places. Its further development will involve dealing in foreign currencies. Some people believe that there already exists a foreign exchange market in China. They are thinking of the currency exchange centres in some port cities in south China. But these centres only handle the foreign exchange retained by departments or enterprises, and are not full-fledged markets.

Opening a portion of the foreign exchange market in China is a requirement of the development of the commodity economy, as well as a requirement of the macro-control of foreign exchange itself. The planning of foreign exchange cannot be achieved by carrying out the macro-control policy only; there must also be micro market regulation. This is where the planned economy and commodity economy are contradictory and unified at the same time.

To make macro-control of foreign exchange more effective, four things need to be considered. First, a portion of the foreign exchange

market should be opened up. Under the system of planned commodity economy in socialist China, the planned economy is after all principal; not all the foreign exchange can be allocated through the market. If we open the foreign exchange market wholly, the state's supply of foreign exchange to the planned economy would not be guaranteed. It is thus impossible for China to do that. What China can and will do is open a portion of its foreign exchange market.

Second, that part of the foreign exchange market opened should reflect in part the real value of Renminbi against foreign currencies. The most important economic lever of the macro-control of foreign exchange is the exchange rate of Renminbi. In the absence of a foreign exchange market, the state-fixed exchange rate of Renminbi is arbitrary; its real value against foreign currencies is unknown. The exchange rate of Renminbi on the opened part of the foreign exchange market will undoubtedly represent, to a certain degree, the real value of Renminbi against foreign currencies. The exchange rate formed on the market thus serves as a reference for the central bank in macro-controlling the exchange rate. If the market exchange rate of Renminbi fluctuates violently, the central bank can use the market mechanism to intervene appropriately.

Third, those who are allowed to sell foreign exchange on the market at the free exchange rate should be those who suffer losses from exporting when the account is settled according to a state-fixed exchange rate; those who are required to buy foreign exchange from the market at the free exchange rate should be those who make excessive profits from importing when the account is settled according to the state-fixed exchange rate. The fluctuations in the exchange rate on the market will help balance the current account. The amount of foreign exchange supplied to the market should make up 10-20 percent of the total value of trade. Of course, if market regulation plays a positive role in the macro-control of foreign exchange, the market can be opened wider. But because socialist countries lack experience in making use of the foreign exchange market, in the beginning it is better to open only a small part.

Fourth, opening part of the foreign exchange market will curb or eliminate black market deals in foreign exchange, deals that exist due to the excessively high value of the Renminbi. Some people hold that opening a foreign exchange market will fuel the skyrocketing of the exchange rate. We think this will not happen. Since there is a foreign exchange market, the scope of loss on export commodities and the scope of profits on import goods determine the ceiling of the market exchange rate. Even if there is a black market exchange rate, that rate will not exceed the ceiling of the market exchange rate. If

the domestic commodity prices can be controlled appropriately, this ceiling on the market exchange rate will not move too high. Generally, the black market exchange rate is the highest since it involves risks for the dealers.

To reiterate, establishing an effective central banking system and opening part of the foreign exchange market are two prerequisites for the implementation of the macro-control of foreign exchange.

4

The Commodity Composition of Imports and Exports

Xu Xianquan

In the past thirty or so years, China's foreign trade has seen a big development. The export volume has increased about fifty-fold, from US $550 million in 1950 to US $27 billion in 1986. This represents an average annual growth rate of 11.4 percent, higher than that of the United States, India, Brazil and other big countries, and also higher than that of world trade as a whole.

To some extent it can be said that this export growth was achieved by improving the mix of export commodities. Of the total value of exports, the proportion of manufactured goods has increased from 20.6 percent in 1953 to 53.8 percent in 1983, and during the same period the proportion of primary products has diminished from 79.4 percent to 46.2 percent. This reflects the development of China's national economy. However, the proportions of the products of these two broad categories have been stable at about 50/50 since around 1956. This is mainly because of the rapid development of China's oil industry and the rapid growth of oil exports. Oil has become China's largest export commodity in terms of export value, accounting for nearly a quarter of total export earnings in the first half of the 1980s. Although the proportion of many primary products was reduced, the proportion of primary products as a whole has not diminished, because of the growth of oil. In 1986, as the oil price dropped sharply, China's oil export earnings also fell.

I. Economic Development and the Mix of Exports

The change in the mix of exports takes the development of the national economy and the change of industrial structure as its prerequisite. During the early years after the establishment of the People's Republic, primary products occupied about 80 percent and industrial finished products only 20 percent in the mix of China's exports. This shows that China was then an agricultural country with a backward economy, and her industrial production level was rather low, with the output of industry (including handicraft industry) occupying only one-third of the gross value of industrial and agricultural output (GVIAO).

With the restoration and development of the national economy and the victorious accomplishment of the First Five-Year Plan, an elementary industrial foundation was laid in China. From 1950 to 1957 GVIAO increased at an average annual rate of 13.4 percent, of which the industrial output grew by 22.4 percent per annum, and the volume of exports at 16.4 percent. But after 1957, because of faulty policies and the lack of experience, the development of the national economy was seriously set back, and the growth of exports slowed down significantly. In the Second Five-Year Plan (1958-62), the production of industry and agriculture was basically at a standstill and even experienced an absolute decline in the two years 1961 and 1962. Then an adjustment was made, bringing about a rapid restoration of output from 1963 to 1965. In the period from 1957 to 1965, the average growth rate of GVIAO fell to 6 percent, of industrial production to 8.9 percent, and of exports to 4.4 percent.

In the sixteen years from 1950 to 1965, though there were twists and turns, the development of China's economy was generally fairly fast, and the structure of the economy underwent a remarkable change. The proportion of industrial production in GVIAO increased from 33 percent to 64 percent. With this change in the economic structure, an enormous change also occurred in the mix of export commodities. Among the primary products, the proportion of cereals, edible oils, and foodstuffs remained basically unchanged, being about 30 percent of exports, while the proportion of raw materials fell from 33.3 percent in 1953 to 15.1 percent in 1965. Among the finished products, the share of textiles and other light industrial goods in exports increased remarkably, growing from 12.3 percent in 1953 to 31 percent in 1965.

After 1966, however, the national economy suffered great losses, and foreign trade was also adversely affected. From 1966 to 1970 China's export growth basically came to a standstill and in some years even fell. The composition of exports saw no improvement in the ten years from 1966 to 1976; on the contrary, the proportion of primary products increased slightly and that of finished products declined somewhat.

After 1977, with the restoration and development of the national economy and especially with the implementation of the open-door policy, a rapid development occurred in foreign trade. In 1986 the value of exports reached US $27.1 billion, compared to US $6.9 billion in 1976, for an average annual growth rate of 14.7 percent.

During this period primary products and finished products each accounted for about 50 percent in the mix of exports, but great changes took place within the primary products category. The

proportion of cereals, edible oils, and foodstuffs diminished from 24.2 percent in 1966 to 14.5 percent in 1983, and raw materials fell from 15.2 percent to 9.5 percent, while the proportion of minerals and fuels increased remarkably. China started to export petroleum in 1971, and by 1976 the export of crude oil and refined products reached US $842 million, 12.7 percent of the total volume of China's export. This share jumped to 21 percent in 1983. However, the mix of industrial finished products saw little change. Although the export value of light industrial and textile products doubled, their share of total exports remained at a level of about one-third. By contrast, the share of machinery and electronic products increased from 3.5 percent in 1976 to 14.9 percent in 1983.

However, it remains true that China's exports are predominantly labour- and resource-intensive products, with relatively little technological sophistication, and generally with little value added.

II. Problems in the Current Composition of Exports

From an overall point of view, the main problem that exists in the composition of China's exports at present is the slow pace of change. For many years Chinese export commodities have remained low in quality and technologically backward, failing to meet the needs of the international market.

At present, the share of energy resources is too big (more than one quarter of total exports). It is unwise to rely on energy exports (or any particular category of exports) too heavily, and what's more, the shortages of energy supply within China cannot be easily overcome in a short period. It is therefore not wise to rely too much on the export of petroleum.

The long stagnation of the export of machinery and electronic products is what prevents a significant improvement in export composition. For twenty years the export of machinery and electrical appliances has been basically at a standstill. For this, there is an historical reason and a structural reason, the latter being more important. The industrialization in the early 1950s laid its emphasis on extensive construction for the establishment of a fairly complete, independent industrial system, and the machinery industry developed accordingly. But at the same time, this brought about serious problems, the fatal ones being the inefficiency of enterprises, poor returns to investment, backward technology, a low level of processing, and lack of variety. Industrial enterprises were built mainly to meet the needs of the domestic market. Consequently, the machinery and electrical appliances now made in China have a low

quality and high cost, and are not competitive internationally. Moreover, in the present system there exist various restrictions and irrational rules and regulations, and enterprises lack the initiative to develop exports, so that the export of machinery and electrical appliances has long been made up of relatively material- and labour-intensive, low-grade products and hand tools, which have a limited degree of processing and low value added. But during this period the trade in machinery and electrical appliances has greatly developed on the international market, now accounting for one-third of world trade.

Prior to the economic reforms, industrial enterprises put undue emphasis on physical output targets, paid little attention to the quality of products, and carried out production without considering the needs of foreign markets. Product designs were out of date, sometimes remaining unchanged even for decades, and there was little or no variety. For example, most textile exports are medium- and low-grade products, suffering from import quotas in the developed countries. The majority of light industrial products are also low-grade, exported mainly to the developing countries. All this is caused mainly by the low-grade and backward product mix.

III. Remedial Policy Measures

As a long-term strategy, China's exports must change from primary products to finished products, from resource- and labour-intensive products to capital- and technology-intensive products, and from low- and medium-grade products to high-grade products. To achieve these changes, the following seven policy measures must be carried out.

First, China must actively pursue the structural reforms of the domestic economy and foreign trade, and implement measures to encourage export. We must make efforts to raise the competitive power of export commodities, speed up industrial upgrading and technical transformation of existing enterprises, improve quality, reduce cost, raise labour productivity, develop a new generation of products, and increase the supply of goods that are well-received abroad. These measures will boost China's ability to increase exports and foreign exchange earnings.

Second, we must adopt effective policies and measures to encourage and support export-oriented enterprises. To raise the initiative of the enterprises, China needs to reduce or remove export duties and allow enterprises to retain a share of the foreign currency earned. Also, we should make available a certain amount of money

to award those enterprises and personnel who provide products of high quality that sell well on world markets.

Third, China must take the export of machinery and electrical appliances as the key link in changing the composition of exports. These products are capital- and technology-intensive; if their export is expanded, the entire composition of exports will undergo a great change.

Fourth, the product mix of textiles and other light industrial goods must move upscale, to change basic consumer goods to consumer goods of high income elasticity and increased value added.

Fifth, China must pursue its international comparative advantage. Since 1986, the revaluation of the Japanese yen has accelerated the adjustment of industrial structure and the international division of labour. The production of labour-intensive textiles and other light industrial goods and low-technology machinery and electrical appliances has shifted to the low labour-cost countries, from which the industrial countries import most of the labour-intensive products they need. This provides an excellent opportunity for China to expand her export of finished products.

Sixth, China should take advantage of its superiority in technology-labour-intensive products and develop the export of ships, electronic products, precision instruments and meters. Also, we should turn our attention to the development of computer software products, which have considerable export potential.

Seventh, China should develop the processing of agricultural products and new-type foodstuffs.

IV. Composition of Exports in the Future

Having due regard for both the international situation and internal conditions, the composition of China's exports in the latter half of the 1980s and the end of this century can be calculated in a preliminary fashion as follows:

	1985	*1990*	*2000*
Total volume	100%	100%	100%
Primary products	54.2	44.7	34.5
Foodstuffs	15.6	18.4	15.0
Raw materials	9.2	7.9	5.7
Fuels (oil and coal)	28.3	18.4	13.8
Finished products	45.8	55.3	65.5
Chemical products	2.3	3.2	3.4
Machines and equipment	3.6	10.5	19.5
Heavy industrial products	3.1	3.9	4.0
Textiles and other light industrial products	31.9	32.4	34.5
Others	4.8	5.3	4.0

As can be seen from these data, the share of primary products declines steadily to the end of the century. The share of labour- and resource-intensive products also declines, from 85 percent in 1985 to 75 percent in 1990 and 65 percent in 2000. Because Chinese machinery and electrical equipment still fall short of world standards, it is not possible to expand these exports in a major way during the Seventh Five-Year Plan. Nevertheless, it is hoped that such exports can reach US $4 billion (10 percent share) in 1990 and US $17 billion (20 percent share) in the year 2000. Because world oil prices in the next five years are likely to remain well below 1985 levels, due to excess supply, and because energy is in short supply in China, the share of oil in total exports will decline significantly. By contrast, agricultural and sideline products will retain an important place in exports, although China's shortage of arable land per capita (less than one-fourth the world average) will prevent any major expansion of agricultural exports. However, the emphasis should shift from general agricultural products to fish breeding, poultry raising, animal husbandry, and processing of sideline products.

V. Composition of Imports in the Future

China is a low-income country, but the composition of her imports is different from other developing countries. China not only exports primary products but also imports industrial raw materials, minerals and other primary products in large quantity. Imports of industrial raw materials constitute a large proportion of total imports; in most years they have comprised 40-60 percent of imports. This pattern of imports is rather similar to that of the developed countries. There are two reasons for this pattern. First, although China has a large territory and rich resources, the endowment per capita is quite limited. Second, the pattern of industrialization in the 1950s emphasized resource-hungry heavy industries.

Another characteristic of China's import pattern is a heavy concentration on a few staple commodities. In recent years, thirteen commodities (steel, nonferrous metals, chemical fertilizers, iron ore, chemical fibres, wool, timber, rubber, pulp and paper, hides, industrial chemicals, wheat, and sugar) have consistently accounted for over 60 percent of total imports.

From an overall point of view, the main problem in the composition of China's imports at present is that the proportion of machinery and equipment is too low, and the proportion of the means of livelihood (including durable consumer goods) and of raw and processed materials is too high.

Not only is the proportion of machinery and equipment low, but their composition is not rational. The problems are: (1) most of the imported equipment is in complete sets, and there is a neglect of importing key equipment; (2) there is too much stress on importing hardware but a neglect of importing software; (3) most of the imports are of general technology, not advanced or specialized technology; (4) the majority of imported items are ordinary equipment or parts and components for manufacturing durable consumer goods; and (5) there is a serious problem with repeatedly importing the same goods.

With a view to speeding up the Four Modernizations, the composition of China's imports during the Seventh Five-Year Plan and at the end of this century can be calculated in a preliminary way as follows:

	1985	*1990*	*2000*
Total imports	100%	100%	100%
Means of production	82.8	85.0	88.0
Machinery and equipment (including the import of technology)	31.9	39.0	48.0
Raw and semifinished materials	50.9	46.0	40.0
Means of livelihood (consumer goods)	17.2	15.0	12.0

To increase the share of machinery and equipment in imports is of great importance. We must make efforts to stress the import of software, advanced technology, and key equipment, to exercise control over the import of general processing equipment and assembly lines, and to reduce gradually the import of raw and semifinished materials. By improving the technical level in processing and manufacturing industries we will increase our self-reliance in the production of raw and semi-finished materials; thus we will be able to reduce imports of these items.

5

The Organizational Structure of China's Trade

Bian Zhenhu, Fei Shunlian and Li Weicheng

I. A Capsule History to 1978

The institutional setting of foreign trade involves a combination of administration and co-ordination, encompassing organizational forms, the division of management powers, the forms of management, and policy systems. China's foreign trade structure includes import and export planning, financial affairs, import and export management and administration, and the allocation of foreign exchange.

The economy of New China in 1949 inherited the problems caused by the "three big mountains" of imperialism, feudalism, and bureaucrat-capitalism. As a first step toward solving these problems, the Common Programme adopted by the Political Consultative Conference in 1949 stipulated that "China enforces control of foreign trade and adopts a protective trade policy." The Chinese government promptly abolished all the foreign prerogatives that had been built up under the Unequal Treaties. The foreign trade enterprises belonging to the Kuomintang government and to bureaucrat-capitalists (capitalists closely associated with the old regime) were immediately expropriated, while the enterprises belonging to national capitalists (those sympathetic to the new regime) were gradually incorporated into the state system through the policies of "utilization, restriction, and transformation." The Customs Administration was also reformed, and strict controls were imposed on foreign exchange transactions. In this manner, a socialist foreign trade structure was set up, with state-owned enterprises monopolizing the channels of trade.

This basic structure then evolved through three stages by 1978. The initial stage lasted about three years. The national economy was reviving, and external trade was conducted on a small scale, with the USSR and East European countries as the main partners. The second stage began in 1952, when the Ministry of Foreign Trade was established. The general pattern was one of increasingly strict central control over foreign trade, with various specialized trading companies evolving gradually to handle the trade in particular commodities. Eventually, after several reforms and consolidations, these specialized companies numbered eleven, handling respectively cereals, oils, and foodstuffs; native products and animal by-products;

textiles; light industry products; chemicals; minerals and metals; machinery; technology; instruments; packaging materials; and transport. This pattern of tight central control continued until about 1974. The general foreign trade strategy during this era was for "each to make up what the other lacks"—a strategy that derived from the theoretical view that our economy was a product economy, not a commodity economy. That is, the pattern of imports and exports tended to reflect the shortages and surpluses that emerged from the physical planning process, with little attention paid to relative costs. This was not satisfactory, since it failed to pay due attention to absorbing foreign advanced technology or to exploiting the international division of labour.

In the early 1960s, the change in the international situation, in particular the deterioration of the Sino-Soviet relationship, prompted China to turn to the capitalist countries for the expansion of foreign trade. However, Chinese exports had difficulty meeting the competition on these markets, where patterns of demand change frequently and high quality is required. Then came the "cultural revolution," which damaged the foreign trade system severely.

The third stage began about 1974, as China began to recover from the damage of the "cultural revolution" and to experiment with tentative forms of decentralization in foreign trade. Specifically, the Ministry of Foreign Trade carried out the following reform measures:

(1) in addition to the provinces along the coast, which were already involved in foreign trade, the provinces of Jiangsu, Hebei, and Zhejiang, and the Guangxi Zhuang Autonomous Region, were authorized to participate more directly in foreign trade;

(2) provinces, municipalities, and autonomous regions with suitable circumstances were entitled to export directly to Hong Kong and Macao;

(3) specialized export commodity supply companies were to be established in light industry, petrochemicals, farm machinery, and building materials;

(4) a machinery and equipment import and export company was going to be established under the First Ministry of Machine Building Industry, to co-ordinate and integrate the entire process from initial production through negotiation with foreign partners to final delivery of goods;

(5) personnel from production units and departments were to participate in the Guangzhou export fair and smaller trade fairs, and go abroad to make investigations and promote sales; and

(6) with the exception of certain articles that remained under the control of higher authorities, import orders paid for by local author-

ities with their own foreign exchange could be placed with local branches of the foreign trade companies.

Of these early reforms, a particularly important aspect was the attempt to establish better integration between production units and foreign trade units. As early as the 1960s, the foreign trade authorities had set up several export commodity production bases (mostly for farm products). However, for various subjective and objective reasons, these early efforts were not particularly successful. The special characteristics of foreign trade (involving foreign languages, foreign currencies, higher quality products, frequent changes in demand, the need for timely delivery, and so on) were generally not well understood by domestic production enterprises. Thus, a closer linkage between the foreign trade authorities and the production enterprises was needed, with the foreign trade units helping to organize, and even taking direct part in, the production of exports. Early in the 1970s, the Ministry of Foreign Trade joined hands with various provincial, municipal, and regional governments to investigate and select certain industrial and agricultural units with favourable conditions (natural resources, technology, and transportation) to concentrate on the production of export commodities. These specialized units, which have come to be called "export commodity production bases" (*chukou shangpin shengchan jidi*), often receive capital, materials, or other assistance from the foreign trade authorities, and in turn sign contracts to provide goods that meet export requirements.

Despite these preliminary reforms, several problems continued to hamper foreign trade efforts: administration and management were over-centralized, restricting the initiative of local authorities; no distinction was drawn between the administrative functions of government and the managerial functions of enterprises; production and trade were still not well linked, so that changes in the foreign trade situation did not lead to changes in domestic production decisions; excessively rigid controls on foreign exchange hampered economic performance; and the general style of doing business was still too bureaucratic—too many levels, too many complicated procedures, and too little efficiency.

II. Recent Reforms in the Foreign Trade Structure

Since the decision to pursue an "open door" policy was made at the Third Plenum in late 1978, the evolution of China's trade structure has entered a fourth phase, and reforms have spread to all foreign trade units. Up to the present, the reforms have encompassed six aspects.

A. Readjustment of the Leading Bodies

In 1979, the National People's Congress decided to establish the State Import and Export Administration to organize, co-ordinate, and administer the foreign trade activities of all relevant units. However, after a trial period of more than two years, the Administration proved to be a failure—its management was fragmented, inefficient, and working at cross purposes. In March 1982 the Administration was amalgamated with the Ministry of Foreign Trade, the Ministry of Foreign Economic Relations, and the State Foreign Investment Administration to form the new Ministry of Foreign Economic Relations and Trade (MOFERT). This new ministry is now in charge of all of China's foreign trade activities and economic co-operation.

B. Further Decentralization of Foreign Trade Management.

To accomodate the growing needs of trade, the trade management powers of local authorities and production units have been enlarged, and the policy of multi-level management of export commodities has been adopted. The specialized import and export corporations affiliated with MOFERT will continue to handle large, important and highly competitive transactions, as well as articles that require unusual processing or shipping.Other commodities, however, will be dealt with by the local branches of the MOFERT corporations, by the export companies of the production ministries, or even by local units where authorized.

To strengthen the integration of production and trade, import and export companies have been set up under more than ten production ministries, including metallurgy, non-ferrous metals, electronics, and shipbuilding. Several provincial-level governments (Guangdong, Fujian, Shandong, Beijing, Shanghai, and Tianjin) have also established their own foreign trade corporations.With the exception of Taiwan and Tibet, all the provincial-level authorities, plus the nine local markets of Guangzhou, Dalian, Wuhan, Xian, Shenyang, Harbin, Chongqing, Qingdao, and Hainan Island, have established foreign trade ports to handle import and export transactions within their respective jurisdictions. As well, several large industrial complexes with good management experience (such as the Capital Iron and Steel Company, Anshan Iron and Steel Company, Yanshan Petrochemical Company, and Harbin Flax Mill) have been given the power to engage in foreign trade. If unified industrial-commercial enterprises such as the China National Petrochemical Corporation and comprehensive entities such as the China

International Trust and Investment Corporation (CITIC) are taken into account, China now boasts more than 1,000 enterprises that have been approved to participate directly in foreign trade.

C. Reform of Planning and Financial Systems

Since 1985, the scope of centralized import and export planning has been greatly reduced. The aggregate level of imports and exports remains a mandatory central target, and commodities traded in large volume or otherwise of special importance to the national economy are still included in the mandatory central plan. Within this overall framework, however, the detailed planning for other commodities is left to the local units authorized to engage in foreign trade. Thus, the structure of trade planning can now be said to have both a "vertical" and a "horizontal" character. Reforms have also been instituted in the financial realm. Previously, foreign trade units were connected to the Ministry of Finance only indirectly, throught MOFERT. Now, some trade units are authorized to deal directly with the Ministry of Finance, and most units are to be independent financial entities, responsible for the own profits and losses from foreign trade.

D. Administration on Two Levels

In China, the function of foreign trade administration is to supervise and guarantee the implementation of relevant government policies and to control the trade volume through quotas and licenses. Starting from 1985, this function has been exercized at two levels in order to tap fully the initiative of both central and local authorities. The central level includes MOFERT and its representatives in major trading ports. The local level covers provincial-level authorities as well as those cities that are entitled to make separate import and export plans.

Through license management, the state can effectively control the volume of imports and exports, safeguard its own interests and enable trade to be carried out in an orderly manner so as to increase the competitiveness of its commodities on the international market. Thus, price control is an important aspect of licensing, and exports will be restricted if the proposed prices fall below specified minimum price levels. On the export side, China began to implement the "Provisional Measures for the Export License System" in October 1980 and by 1982 had instituted license management of 87 commodities in short supply at home. By 1986, 235 commodities were subject to licensing requirements. For certain types of goods (valuable cultural relics, endangered species of animals, gold and silver,

currency, and restricted scientific and technical data) export is entirely prohibited. The next category covers goods whose export is restricted: strategic materials, commodities essential to the national economy and the people's livelihood, materials for which there is a state monopoly on trade, and commodities subject to orderly marketing agreements and other negotiated arrangements that restict export quantities. Finally, there is the broad residual category of goods for which export is not restricted.

On the import side, commodities also fall into three broad categories: prohibited items (obscene materials, reactionary materials, superstitious articles, narcotics, and so on), controlled items (restricted in order to protect domestic producers or for balance of payments reasons), and finally all other items. China's "Provisional Measures for Foreign Trade Import Management" stipulate that those who wish to import must apply for a license before they can place orders for goods from abroad, and that at the time of delivery the Customs will inspect and approve clearance in accordance with the terms of the import license. There are 45 commodities in the controlled category, 16 of which are under state monopoly control and 29 of which can be handled by other approved foreign trade units provided they obtain import licenses in accordance with the import plan. For imports outside the controlled category, approved foreign trade units need not apply for a license, but other entities must still obtain the approval of the appropriate superior authorities, a certificate for the use of foreign exchange, and an import license.

The two-level administration of foreign trade has not been without its problems. Inevitably, there was a certain amount of confusion with the new system, and during the second half of 1985 intense competition developed between the various foreign trade units, which led to excessive importing. In response, it was necessary to increase the vigilance of administrative units.

E. Intensification of Economic Regulation of Trade

Paralleling the nation's reforms of the domestic economic structure, the handling of foreign trade has also been reformed, with increased emphasis on economic levers and reduced emphasis on administrative methods. These economic incentives take various forms:

(1) Access to foreign exchange: Under recent reforms, local governments and enterprises are allowed to retain control over a specified percentage of their foreign exchange earnings. Half of the amount retained is to be used by the enterprises to import materials, acquire technology, send inspection teams abroad, and so on, while

the other half is to be used by local governments to provide key infrastructure.

(2) Enterprise taxation: In 1984 an adjustment tax was imposed on enterprises, in addition to the industrial and commercial tax and the income tax already being paid. Now, in line with international practice, partial or complete remission of the adjustment tax can be granted to enterprises that export manufactured goods.

(3) Customs duties: Tariffs not only increase the state's financial revenue but also are important economic levers in the management of foreign trade. Over the years, there have been many changes to the import and export tariffs on particular commodities, designed to encourage or discourage trade in these items. For example, in November 1981 China adjusted the import tariffs on television sets, tape recorders, and computers, reduced the import tariffs for rubber, timber, leather, paper, and certain kinds of machinery and equipment, and increased the import tariffs on other kinds of machinery and equipment. Recently, as part of the open policy, we have granted a wide variety of tariff reductions and exemptions to "open door" ventures for their foreign purchases of raw materials, equipment, and technology.

(4) Pricing policy: In the past, prices in China did not adequately reflect differences in product quality. Now, although a fundamental reform of the pricing system has not yet been carried out, the prices of exports have become more flexible and are linked to product quality.

F. Encouragement of Horizontal Economic Integration

In the past, production units in industry and agriculture were not well integrated with the foreign trade organizations, nor were the coastal ports closely linked to the hinterland. This hampered the expansion of export trade and the improvement of economic results. In recent years, co-operation has been strengthened between provincial and municipal foreign trade companies, industrial enterprises, and agricultural production units. They open joint offices, and jointly they arrange production, hold talks with foreign firms, and make inspection tours abroad. Beijing, Tianjin, and Shanghai have taken the lead in setting up this kind of co-operation, and various provinces and autonomous regions have followed suit. Successful examples include the Shanghai Toy Factory, Zhejiang Handicrafts Company, Jiangsu Ceramics Company, and Tian'e Woollen Blanket Company of Tianjin. Also successful have been the comprehensive export production bases set up at Foshan in Guangdong, Suzhou in

Jiangsu and Qingdao in Shandong, as well as the single-commodity production bases that now supply live pigs, live poultry, fruit and vegetables to Hong Kong and Macao and supply a wide variety of native products to markets in Japan and Southeast Asia. The importance of all of these varied types of export commodity production bases is demonstrated by incomplete statistics that indicate that such bases provided 22.8 percent of China's exports in 1985.

The success of these bases has led to the recent decision to intensify construction of such bases and, where appropriate, unite them into integrated export production systems, which will be networks composed mainly of production enterprises but will also incorporate trade, research, and transport units, reaching across regional and departmental boundaries. As a first step, China's exports have been grouped into three broad categories: machinery and electronic products, textiles and other light industrial goods, and farm and sideline products. Within each of these broad categories, special efforts will be made to identify and foster production of commodities that have special potential in international markets.

III. Plans for Further Reforms

The reforms to date have brought significant changes to China's foreign trade structure. These have included a partial decentralization of administration, the development of economic incentives to supplement administrative measures, and the development of horizontal co-operation to dilute the traditional vertical control of central agencies. However, it is essential for us to notice that the reform measures are only in their initial stages. The new structure has not yet taken the place of the old; in-depth developments are needed to complete the reform.

Accordingly, the targets for future reforms will be as follows: further separation of the administrative functions of government trade departments from the managerial functions of enterprises; invigoration of enterprises by giving them more autonomy; increased use of flexible macro-economic levers to control trade; promotion of links between production units and foreign trade units, between technology and trade, and between imports and exports; and encouragement of economic results by eliminating the financial "big rice bowl."

Foreign trade is complex and multi-faceted. It is closely linked to the domestic economy. Therefore we will take an active but cautious approach toward the reform of its structure. In view of the current situation, where there are huge deficits in the current account

balance and the new economic system exists side by side with the old, reforms of the trade sector must progress in step with developments in the rest of the national economy. Nevertheless, reform of the foreign trade structure is progressing in a planned way, under the guidance of the open policy. We expect that a socialist foreign trade structure with Chinese characteristics and inexhaustible vitality will emerge in the not-too-distant future.

6

Encouraging Foreign Investment

Wu Chao

Since the implementation of the open door policy in 1979, China, overcoming the disruptions caused by "left" ideology in economic construction, has been absorbing and utilizing direct foreign investment by setting up various forms of enterprises (including Sino-foreign joint ventures, co-operative ventures, and entirely foreign-owned enterprises). On July 8, 1979, the Law of the People's Republic of China (PRC) on Chinese-Foreign Joint Ventures was promulgated and went into effect. China has since enacted many laws and regulations directly or indirectly concerning foreign investment. Meanwhile, in the light of the actual situation and by learning from some developed countries, China has adopted a series of policies to encourage foreign investment. As China is rich in natural resources and has cheap labour resources and a vast domestic market, plus various preferential terms for foreign investment, China has become very attractive as an investment venue. In the short span of eight years, China has made much headway in absorbing direct foreign investment. According to incomplete MOFERT statistics, by the end of 1986, business people from abroad and from Hong Kong and Macao had signed 8,189 agreements or contracts, involving a total foreign investment of US $19.99 billion, of which US $8.30 billion had already been utilized. (For details, please see Tables 6.1-6.4, pages 54-55.)

Of the more than six thousand enterprises involving foreign investment that have been approved, upwards of two thousand have gone into operation, and most of them have achieved satisfactory financial results. They have played a positive role by introducing foreign capital to make up for the deficiency in domestic construction funds and by transferring advanced technology and management expertise to speed up socialist construction.

The experience of the last few years shows that foreign-funded enterprises can survive and flourish in socialist China; moreover, they have great vitality and a bright future.

The Chinese government has always attached great importance to the introduction of direct foreign investment and has adopted a series of effective policies and measures to encourage and support this effort, including the following major points: stipulating clearly the orientation and emphasis of the foreign investment to ensure

that foreign investment absorbed will generate good financial results and social benefits as anticipated; upholding the principles of equality and mutual benefit to ensure that both sides gain satisfactory results from their investment; ensuring that the foreign-funded enterprises enjoy full autonomy and adopt advanced and scientific management methods; offering the foreign-funded enterprises as much help as possible in solving their problems, including the marketing of products and the balancing of foreign exchange income and expenditures; and striving to improve the investment environment by perfecting legislation and readjusting policies to provide greater convenience and appropriate preferential terms for the foreign investors.

I. Clarifying the Goals of Foreign Investment

Specifying clearly the orientation and emphasis of foreign investment is a prerequisite for the effective utilization of foreign capital. The Seventh Five-Year Plan stipulates that during this period China will give highest priority to construction projects in such areas as energy, transport, communications, and raw and semi-finished materials, and especially to projects for power generation, port facilities, and the petroleum industry and to the technological transformation of the machine-building and electronics industries. China will give second priority to projects that will increase China's ability to earn or conserve foreign exchange through exporting or import replacement. This will create conditions for China to strengthen its debt servicing ability and encourage further foreign investment. In this context, projects involving advanced technology and methods, which produce new products, new equipment and new materials that China needs badly will be emphasized. This will help boost our productive forces and narrow the gap between China and developed countries. Scarcity of foreign exchange will remain a serious constraint on China's economic construction for a long time to come. If we cannot increase exports, we will not have enough foreign exchange to import materials we need for our development and will have to reduce the scope of foreign capital utilization and international economic and technological co-operation.

From now on, the state will curtail the use of foreign investment in projects of the following types:

(1) projects involving advanced technology which other Chinese enterprises have already imported, projects which create excess production capacity, or projects which cannot export all or part of their output—such as colour televisions, refrigerators, and other household appliances;

Table 6.1
Foreign Investment in China, 1979-85

	Number of Contracts	Amounts Contracted Value (US$ mill)	Amounts Contracted Share (%)	Amounts Implemented Value (US$ mill)	Amounts Implemented Share (%)
Joint Ventures	2,343	3,412	20.5	1,008	16.6
Co-operative Ventures	3,823	8,210	49.3	1,809	29.8
Joint Resource Development	35	2,783	16.7	1,792	29.6
100% Foreign Owned	120	517	3.1	111	1.8
Compensation Trade	1,370	1,254	7.5	869	14.3
Other	n.a.	486	2.9	473	7.8
Total	n.a.	16,661	100.0	6,061	100.0

SOURCE: China Foreign Trade Economic Yearbooks for 1984-86.

Table 6.2
Investment in China by Source, 1979-85

Country or Region	Value of Contracts (US$ million)	Share (%)
Hong Kong/Macao	10,629	63.8
United States	2,177	13.1
Japan	1,629	9.8
Britain	3,78	2.3
France	262	1.6
Singapore	193	1.2
Fed. Rep. of Germany	162	1.0
Italy	137	0.8
Australia	105	0.6
Canada	74	0.4
Belgium	53	0.3
Brazil	50	0.3
Philippines	47	0.3
Thailand	40	0.2
Sweden	38	0.2
Jordan	33	0.2
Other	654	3.9
Total	16,661	100.0

SOURCE: China Foreign Trade Economic Yearbooks for 1984-86.

Table 6.3
Investment in China by Destination, 1979-85

Province or Other Unit	*Share (%)*
Guangdong	37.7
Central Ministries	19.5
Shanghai	11.2
Fujian	5.9
Beijing	4.7
Shaanxi	3.8
Liaoning	2.8
Shandong	2.0
Jiangsu	1.6
Tianjin	1.6
Sichuan	0.8
Zhejiang	0.8
Others	7.6

SOURCE: China Foreign Trade Economic Yearbooks for 1984-86.

Table 6.4
Sectoral Composition of Foreign Investment in China, 1983-85

Sector	*Share (%)*
Real Estate and Public Service	29.7
Industry	29.4
Geological Prospecting	12.4
Service and Catering	6.1
Construction Industry	2.4
Transport, Post, and Telecommunications	2.2
Agriculture and Fisheries	2.0
Finance and Insurance	0.6
Culture, Education, and Public Health	0.6
Science and Technology	0.1
Other	14.5

SOURCE: China Foreign Trade Economic Yearbooks for 1984-86.

(2) projects which neither export their output nor absorb advanced production technology and management expertise — such as taxi cab companies; and

(3) projects whose products are subject to state export quotas — such as cotton, woollen, and linen fabrics.

Projects completely prohibited include those that are generally not allowed to be set up internationally because they are harmful to state sovereignty and security or because they contaminate the environment. They also include projects that simply import assembly lines and foreign parts and components to produce solely for the Chinese market.

To stimulate appropriate foreign investment, the Provisions for the Encouragement of Foreign Investment promulgated by the State Council on October 11, 1986 (hereafter referred to as the New Provisions) contain a series of preferential terms for foreign-funded enterprises that are export-oriented and technologically advanced.

By export-oriented enterprises, we mean enterprises whose products are mainly for export, which have a foreign exchange surplus after deducting from their total annual foreign exchange earnings the foreign exchange needed for importing components and materials and for remitting the foreign partner's profits. By technologically advanced enterprises, we mean enterprises possessing advanced technology supplied by foreign investors and engaged in developing new or improved products in order to increase foreign exchange earnings by exporting or to conserve foreign exchange by import replacement. In both types of enterprises, foreign investors incur high costs and often encounter complicated production and management problems. If there were no preferential investment environment, the prospects for profit would be discouraging, and it would be hard for us to attract foreign investment. Therefore, the New Provisions offer the following preferential arrangements:

(1) Reduced production costs. In accordance with the Provisions for Labour Management in Chinese-Foreign Joint Ventures, a joint venture must pay the labour insurance and medical expenses of the Chinese staff and workers, as well as the various government subsidies for staff and workers, in accordance with the standards for state enterprises. According to the New Provisions, the two preferred kinds of enterprises are exempt from payment to the state of all subsidies to staff and workers.

In accordance with regulations issued in 1980, the site use fee of a joint venture project ranges from five to three hundred RMB yuan per square metre per year, but the regulations didn't specify whether this fee includes the site development fee. Under the New Provisions,

the site use fees for export enterprises and technologically advanced enterprises, except for those located in busy urban sectors of large cities, shall be computed and charged according to the following standards: five to twenty RMB yuan per square metre per year in areas where the development fee and the site use fee are computed and charged together; not more than three RMB yuan per square metre per year in site areas where the development fee is computed and charged on a one-time basis or areas which are developed by the above-mentioned enterprises themselves. Exemptions from these fees for specified periods of time may be granted at the discretion of local governments.

(2) Tax reductions and exemptions. In accordance with the Income Tax Law on Joint Ventures, when a foreign partner in a joint venture remits its share of profit from China, a remittance tax of ten percent shall be levied. In accordance with the New Provisions, the export and technologically advanced enterprises are exempt from this tax.

To reduce the tax burden of the export and technologically advanced enterprises, the New Provisions stipulate, "After the expiration of the period for the reduction or exemption of enterprise income tax in accordance with the provisions of the state, export enterprises whose value of export products in that year amounts to 70 percent or more of the value of their products for that year, may pay enterprise income tax at one-half the rate of the present tax. Export enterprises in the Special Economic Zones and in the economic and technological development zones and other export enterprises that already pay enterprise income tax at a tax rate of 15 percent and that comply with the foregoing conditions, shall pay enterprise income tax at a rate of 10 percent." The New Provisions also provide that "after the expiration of the period of reduction or exemption of enterprise income tax in accordance with the provision of the state, technologically advanced enterprises may extend for three years the payment of enterprise income tax at a rate reduced by one half."

Article 6 of the Income Tax Law on Joint Ventures stipulates: "A participant in a joint venture which reinvests its share of profit in China for a period of not less than five years may, upon approval by the tax authorities of an application filed by the said participant, obtain a refund of 40 percent of the income tax paid on the reinvested amount. A participant which withdraws its reinvested funds within five years shall pay back the tax on the amount refunded." In accordance with the New Provisions, foreign investors who reinvest the profits distributed to them by their enterprises in

order to establish or expand export enterprises and technologically advanced enterprises in China shall be refunded the total amount of enterprise income tax on the reinvested portion.

(3) Improved operating conditions. To improve the production and operating conditions of the export and technologically advanced enterprises, the New Provisions stipulate that they will be given priority in obtaining water, electricity, transport services, and communication facilities needed for their production and operation. Fees shall be computed and charged in accordance with the standards for local state enterprises. Export enterprises and technologically advanced enterprises, after examination by the Bank of China, shall be granted priority in receiving loans for short-term working capital.

II. Upholding the Principle of Equality and Mutual Benefit

The principle of equality and mutual benefit is a principle which has always been observed in China's foreign economic relations. Sincerely implementing this principle is of particular importance for Sino-foreign joint ventures, co-operative enterprises, and solely foreign-owned enterprises, which have the following characteristics: First, the two sides work in close co-operation. Second, the co-operation is comprehensive, involving personnel, finance, materials, supply, and marketing. Third, the co-operation period is lengthy, ranging up to thirty or even fifty years in some instances.

In regard to foreign investment, the principle of equality and mutual benefit has two facets: the Chinese government protects, according to law, the foreigners' investment, their profits, and other legal rights and interests; at the same time, foreign investors must observe the laws of the People's Republic of China and fulfill the obligations prescribed by the law. This has been written into Article 18 of the Constitution of the People's Republic of China, which says, "... All foreign enterprises and other foreign economic organizations in China, as well as joint ventures with Chinese and foreign investment located in China, shall abide by the laws of the People's Republic of China. Their lawful rights and interests are protected by the law of the People's Republic of China." To reinforce these guarantees, Article 16 of the New Provisions states, "All districts and departments must implement the 'Circular of the State Council Concerning Firmly Curbing the Indiscriminate Levying of Charges on Enterprises.' The people's governments at the provincial level shall formulate specific methods and strengthen supervision and administration. Enterprises with foreign investment that encounter unreasonable charges may refuse to pay and may also appeal to the local economic committees up to the State Economic Commission."

III. Ensuring the Autonomy of Enterprises

We must exercise effective supervision over the foreign-funded enterprises in accordance with Chinese law and, at the same time, ensure that they enjoy full autonomy. If these enterprises do not enjoy full autonomy and if their management copies the methods of China's state-owned enterprises, the foreign-funded enterprises will inevitably operate poorly, causing dissatisfaction and lack of enthusiasm on both sides. At the same time, measures to enliven the performance of domestic enterprises comprise the current structural reforms of the urban economy. Under these reforms, the state has gradually begun to separate government administration from business management, simplify administrative procedures, and decentralize power to the state-owned enterprises, to enable them to enjoy the autonomy necessary for effective management and operation.

Foreign-funded enterprises are a special kind of economic organization in China, with the following characteristics:

(1) In terms of ownership, enterprises with foreign investment can be divided into two categories: Sino-foreign joint ventures and co-operative enterprises, which are owned jointly by the Chinese investors (generally state-owned enterprises) and foreign investors; and solely foreign-owned enterprises which are owned 100 percent by foreign capitalists but are subject to Chinese law.

(2) In terms of structure, the Sino-foreign joint ventures and co-operative enterprises are managed jointly by the Chinese and foreign investors. Their ultimate authority is the board of directors and its subordinate management units, formed jointly by the Chinese and foreign sides in accordance with a signed contract and articles of association.

(3) In financial terms, the foreign-funded enterprises have discarded the egalitarian distribution system known in China as the "big iron rice bowl" and have become limited companies which practise independent accounting and shoulder responsibility for their own profits and losses.

(4) In economic relations, foreign-funded enterprises maintain a close relationship with the international market. They import some of the raw materials, parts and components they need for production, and sell part or all of their products on the international market.

Because of the above characteristics, the foreign-funded enterprises need to have full decision-making power in labour questions, materials supply, and finance, as well as in production and marketing. The Chinese government has time and again vowed to guarantee their autonomy, demonstrated in the following eight areas:

(1) In accordance with signed contracts and articles of association, these enterprises have the right to decide on their own development and production plans, which are executed by means of economic contracts.

(2) Within their approved business scope, they have the right to purchase from Chinese or international markets the materials they need (including raw materials, fuels, and equipment) and, in accordance with the proportions specified contractually, to sell their products both within and outside China.

(3) While observing China's foreign trade policies, they have the right to decide on the import and export of their own materials, with the full co-operation of MOFERT and Customs. They should be allowed to do business at the various export commodities trade fairs held in China.

(4) They have the right to borrow money in Renminbi or foreign currency from Chinese or foreign financial institutions.

(5) In accordance with their operating needs, they have the right to decide on their organizational structure and staffing, to employ or dismiss senior managers, to recruit or dismiss workers, and to advertise locally for the employment of technical and managerial personnel and workers, whose units should allow them to leave. When circumstances warrant, they have the right to impose sanctions including discharge against staff and workers who violate the rules and regulations of the enterprise and thereby cause harmful consequences. (The decision to employ, dismiss, or discharge workers should be reported to the local labour and personnel department for their information.) They also have the power to decide on the system of wage standards, types of wages, bonuses, and subsidies.

(6) In accordance with relevant regulations they have the right to institute a financial management system which suits their situation, and to decide on their own profit distribution programme and financial budget for revenues and expenditures.

(7) They have the right to set prices for their own products, provided they are not subject to state price controls. They also have the power to make proposals for the prices of their products that are subject to state price controls, but must abide by the decisions of the pricing authorities.

(8) In accordance with the needs of their business, they have the right to invite foreign business people to visit China or to send their own people to hold business talks abroad.

The implementation of the above regulations plays an important role in enlivening the foreign-funded enterprises and bringing their enthusiasm and creativity into full play as well as in enabling them to

adopt internationally advanced scientific management methods. To permit maximum flexibility, only a small number of Sino-foreign joint ventures are subject to the state plan; most of these enterprises are put under market regulation, with government co-ordination occurring mainly through economic levers. For example, by stipulating different tax rates and tax reduction and exemption periods, and by specifying different lending methods and different interest rates, China indicates which sectors are favoured or discouraged, thereby diverting the foreign investment into the areas of the economy where the need is most urgent in terms of China's development priorities.

IV. Balancing Foreign Exchange Income and Expenditures

Foreign investors generally hope to capture a share of the China market, which is the largest in the world, and therefore they want to know whether products of their joint ventures will be allowed to sell in China, and in what quantities. On the other hand, China demands that the foreign-funded enterprises sell a portion of their products abroad and strive to balance their foreign exchange income and expenditure. This is reasonable and necessary, because the foreign-funded enterprises themselves need a certain amount of foreign exchange to purchase inputs and pay dividends abroad, because the pressure of competition in world markets spurs the enterprises to constantly improve their technology and management, and because one of China's key reasons for permitting joint ventures is to use their collaborative strengths to increase export earnings. However, the Chinese government adopts a flexible attitude, and so long as the foreign investor has supplied advanced technology, or the products of the enterprise are what China needs to import for a long period of time to come, China will open part of its domestic market. In these circumstances, however, some foreign-funded enterprises may have difficulty in achieving balance of their foreign exchange income and expenditure.

To provide as much help as possible, the State Council on January 15, 1986 promulgated the "Provisions on the Question of the Balancing of Foreign Exchange Receipts and Expenditures of Sino-Foreign Joint Ventures." Besides asking the joint ventures to export more, these Provisions have the following stipulations:

(1) In cases where the foreign joint venturer provides highly sophisticated products produced with advanced technology or products of superior quality that are internationally competitive, if such products are urgently needed in China, preferential access to the domestic market may be granted.

(2) Sino-foreign joint ventures that produce products that China needs to import over the long term or urgently needs to import, may, in accordance with the quality, specification requirements, and import circumstances of the products in question, and upon approval of the departments in charge, carry out import substitution. This substitution shall be incorporated into the long-term or annual plans for the use of foreign exchange for imports, and the matter resolved in this manner.

(3) In order to achieve a balance between foreign exchange receipts and expenditures, joint ventures may, with the approval of MOFERT, utilize the sales connections of the foreign partner to export domestic products, and carry out overall compensation. However, in the case of products that are centrally managed by the state, have export quotas, or require export licences, the matter must be reported to MOFERT for special approval.

(4) If a joint venture sells to enterprises with the ability to make payment in foreign exchange, and if these customers are in areas other than the Special Economic Zones and the economic and technological development zones of the coastal open cities, then, with the approval of the state foreign exchange control agencies, it shall be permitted to compute the price and settle accounts in foreign currencies.

(5) When a foreign partner establishes two or more joint ventures within China (including in different locations or with different departments), and some of the ventures have a surplus in the foreign exchange portion of their lawful income while some have a deficit, then, upon the approval of the state foreign exchange control agencies, these various joint ventures may balance their foreign exchange accounts among themselves.

(6) With the approval of MOFERT and the foreign exchange control department, the foreign partner in a Sino-foreign joint venture that is not able to balance its foreign exchange receipts and expenditures, may, in accordance with Article 7 of the Law on Sino-Foreign Joint Ventures, reinvest its Renminbi profits from the joint venture in domestic enterprises capable of generating new foreign exchange receipts. In addition to enjoying the preferential treatment of receiving a refund of a portion of the income tax already paid, the foreign partner may use the foreign exchange obtained from this new investment to remit its lawful profits abroad.

The above provisions apply to Sino-foreign co-operative enterprises as well as to joint ventures, but they do not apply to solely foreign-owned enterprises.

For the implementation of the above provisions and to further

help foreign-funded enterprises achieve foreign exchange balance, the State Council, in a document it released later, made the following additional regulations:

(1) The policy of opening the domestic market in return for technology must be implemented resolutely and measures concerning import substitution put into practice. Instead of using imports, China must give priority to using products that have been put into batch production in the foreign-funded enterprises, so long as their quality has fundamentally reached the same level as products made outside China and so long as their prices and delivery time are suitable. The State Economic Commission will specify these categories of products, and will adopt administrative and economic means to restrict import of these products.

(2) When selling products in the categories specified by the State Economic Commission, the joint ventures and co-operative enterprises, with the approval of the foreign exchange control department, are allowed to charge part of their price in foreign exchange, the amount of which should decrease year by year as the use of China-made parts and components increases.

(3) When foreign-financed enterprises sell to Chinese customers they have found for themselves, the accounts may be settled partly or wholly in foreign exchange by mutual agreement, provided the foreign exchange control department approves.

The implementation of the above regulations will play a very important role in helping Sino-foreign joint ventures, co-operative enterprises and even enterprises with 100 percent foreign investment to balance their foreign exchange receipts and expenditures. However, because China needs huge amounts of foreign capital to build up its economy, the problem of foreign exchange shortage will continue for many years. A fundamental way for foreign-funded enterprises to balance their foreign exchange is to choose those projects which will turn out export products or which can produce import substitutes. As much as possible, the project should use China-made components, spare parts and raw materials. This will be difficult in the beginning of a foreign-funded operation since variety, quality, specifications, prices and dates of delivery are unsatisfactory. In the longer term, however, it is necessary and possible to use only China-made components, spare parts, and raw materials in production. Partners in a co-operative project should strive to forge ties with relevant Chinese agencies and enterprises; whenever necessary, they should sign long-term contracts for fixed supply of items needed. In addition, they should export their products strictly in accordance with the ratio set forth in the contract signed.

V. Improving the Investment Environment

By investment environment, we mean the sum total of various factors that will influence the confidence in making investment and the ultimate results. These include natural, economic, social, political, cultural, and technological factors. Among these factors, the natural factor refers mainly to geographical position and natural resources; the economic factor refers mainly to the industrial basis, communications, telecommunications, and market; the political factor refers mainly to political stability, the continuance and adaptability of policies, legal protection, and administrative efficiency; the social factor refers mainly to social security and social features; the cultural and technological factor refers mainly to the educational level of people, their cultural life, and the skills of workers, staff, and management. Of all these factors, the economic and political factors are the most important.

One of the major goals China hopes to attain in opening to the outside world is introducing foreign advanced technology, management expertise, and capital to accelerate socialist modernization. In the last few years, governments at various levels in China have implemented many measures to encourage and support foreign investment:

(1) Establishing special investment regions. Since opening to the outside world in 1978, China has set up four Special Economic Zones at Shenzhen, Zhuhai and Shantou in Guangdong and at Xiamen in Fujian. In 1984 China opened fourteen coastal cities and Hainan Island; the fourteen coastal cities are Shanghai, Tianjin, Dalian, Qinhuangdao, Qingdao, Yantai, Lianyungang, Nantong, Wenzhou, Fuzhou, Guangzhou, Zhanjiang, and Beihai. China also decided to set up economic and technological development zones in these cities. In 1985 China set up three economic zones in the Changjiang (Yangtze) River Delta, the Southern Fujian Delta, and the Pearl River Delta. All of these areas provide preferential treatment to foreign investment, though the details differ from place to place.

Guangdong and Fujian provinces, the four Special Economic Zones included, are neighbours of Hong Kong and Macao. Many of their people reside overseas and in Hong Kong and Macao.

The fourteen open coastal cities are economically developed by China's standards and are places where a galaxy of talents assemble. Although they have only 7.8 percent of the Chinese population, their annual industrial output value accounts for 23 percent of the national total, and their labour productivity stands 66 percent

higher than the national average. Their output value for every one hundred yuan worth of fixed assets is twice the national level. With good transport facilities, they are blessed with large harbours for ocean shipping, river ports for domestic transportation, and railways. Their export value accounts for 40 percent of the national total. The afore-mentioned three deltas also have a solid industrial and agricultural basis. The development and further opening of these places will play an important role in encouraging direct foreign investment.

(2) Construction of infrastructure. Between 1981 and 1985 China completed construction of 54 coastal berths for ships of over 10,000 tons, boosting its harbour handling capacity to 300 million tons. Between 1986 and 1990, China will build 200 more berths including 120 deep-water ones. By 1990 the number of coastal berths will jump to 1,200, including 320 deep-water ones; by then, China's harbour handling capacity will reach 550 million tons. By the end of 1986, domestic air service was available in all the fourteen open coastal cities, and they also installed international telephone and telegraph services. In addition, they made much headway in improving energy supplies and building municipal facilities and tourist hotels. Many places have built or are planning to build hydro-electric power plants, and many plan to expand or renovate water supply and drainage networks.

(3) Perfecting economic laws and regulations. Economic laws and regulations are the surest guarantee for the establishment of foreign-funded enterprises, as well as for their production and operation. Since China opened its doors in 1979, the Chinese government has greatly improved the work of enacting foreign economic laws and regulations, of which fifty-six have been promulgated. Some twenty of these, which are listed in Annex 1, are especially for foreign-funded enterprises. In addition, Guangdong, Fujian, and some other provinces and municipalities have also promulgated regulations on foreign investment in the light of their own conditions. All these laws and regulations have provided a legal basis and protection for the establishment of foreign-funded enterprises, hence promoting the development of the undertakings.

(4) Readjusting certain policies. In the last few years, the Chinese government, to encourage foreign investment in China, improved the production and operation conditions of foreign-financed enterprises. After investigation and study, it made some readjustment of the established policies to make them more attractive. Major contents of the readjustment include:

(a) Extending the tax reduction and exemption period. Article 5 of the Income Tax Law Concerning Chinese-Foreign Joint Ventures

stipulates, "A newly established joint venture scheduled to operate for a period of 10 years or more, upon approval by the Tax authorities of an application filed by the venture, shall be exempted from income tax in the first profit-making year and allowed a 50 percent reduction of income tax in the second and third years." Since 1983, this provision has been modified so that the newly established joint venture shall be exempted from income tax in the first two profit-making years and allowed a 50 percent reduction of income tax in the third, fourth and fifth years.

(b) Improving materials supply. To improve the operating conditions for foreign-funded enterprises, the Chinese government asked the State Material Bureau and local material departments to supply approved materials at reasonable prices, or help bridge the gap between the foreign-funded enterprises and local suppliers. In some large cities where foreign-funded enterprises are numerous, with MOFERT approval the local materials departments may, on a trial basis, help the foreign-funded enterprises import raw materials, parts and fittings in short supply. The Customs will put them under its supervision and control, and will permit reduction or exemption of customs duties as appropriate. This, however, applies only to materials supplied to the foreign-funded enterprises.

(c) Cutting red tape. To facilitate the establishment of foreign-funded enterprises and their production and operation, in view of the fact that some supervisory departments are dilatory in examining and approving contracts and articles of association, the State Council Document No.45 (1983) called for the institution of a joint examination system to simplify procedures. Article 17 of the New Provisions states, "The agreement, contract and articles of association of an enterprise with foreign investment shall be examined and approved by the departments in charge under the State Council. The examination and approval authority must within three months from the date of receipt of all documents decide to approve or not to approve them."

When a foreign-funded enterprise imports machinery and equipment, vehicles used in production, raw materials, fuel, bulk parts, spare parts, components and fittings (including imports restricted by the state), it should apply for import licences when these are required by state regulations. For the convenience of foreign-funded enterprises, the State Council stipulated on October 11, 1986 that when enterprises with foreign investment need to import the above materials in order to carry out their export contracts, they are not required to file further applications for examination and approval and are exempt from the requirement for import licences. The

customs department shall exercise supervision and control, and shall inspect and release such imports on the basis of the enterprise contract or the export contract.

(5) Protecting legal rights and interests of foreign investors. To create a good investment environment for foreign investors, ensure the safety of their investments, and guarantee their legal rights and interests so as to allay their fears of trouble in the future, the Chinese government in the last few years has negotiated agreements with many countries for the protection of foreign investment in China. By the end of 1985, the Chinese government had signed sixteen such agreements with seventeen countries: Switzerland, Sweden, Romania, the Federal Republic of Germany, France, Finland, Belgium and Luxemburg, Norway, Italy, Thailand, Denmark, Holland, Austria, Singapore, Kuwait, and Sri Lanka.

By the end of 1985 the Chinese government had signed agreements on the avoidance of double taxation with governments of sixteen countries: Japan, Britain, France, the Federal Republic of Germany, the United States, Singapore, Malaysia, Thailand, Canada, Italy, Denmark, Norway, Sweden, New Zealand, Belgium, and Finland. The agreements apply to the individual income tax, the Sino-foreign joint venture income tax, and income tax on enterprises with exclusive foreign investment in China—the last two kinds of taxes include local income tax. In any of the sixteen countries, the agreements apply to similar kinds of taxes or taxes which are the same in essence, but the agreements will enable the foreign investors to benefit from China's preferential terms on tax reduction and exemption for their investment in China.

7

China and GATT

Dong Shangming and Wang Lei

I. Relations Between China and GATT

China is one of the founding members of the General Agreement on Tariffs and Trade (GATT). On April 21, 1948, the Chinese government of the time signed the Protocol on Provisional Application. On May 21 the same year, China formally became a contracting party to GATT.

After the founding of New China in 1949, for various historical reasons, such as the economic blockade imposed by the capitalist countries and the abrogation of contracts by the Soviet Union, the Chinese people were forced to carry out economic construction by relying on our own efforts; on the other hand, while China implemented the policy of self-reliance, there existed serious one-sidedness, and self-reliance was mistakenly seen as prohibiting the development of foreign economic relations and trade. As a result, relations between China and GATT were suspended for many years. Since October 1971, when China's lawful seat in the United Nations was restored, our position in various international organizations has been reactivated. During the late 1970s and early 1980s, China began gradually to restore relations with GATT. In 1980 China attended the executive committee conference of the Provisional Committee of the International Trade Organization. In 1981 China attended as observer the International Textiles Trade Agreement Negotiation Conference held under the auspices of GATT. In January 1984 China signed the Multi-Fibre Arrangement (MFA). Since 1982, we have sent our representatives to attend as observers at the GATT meeting of contracting nations, the council meetings, and the various conferences held under it. In the last few years, China has sent people each year to take part in training classes sponsored by GATT for the developing countries. In 1984 we invited experts from the secretariat of GATT to come to run training classes in Beijing, for officials from various Chinese government departments. In January 1986 Mr. Arthur Dunkel, Director-General of GATT, came to visit China on invitation. He exchanged views with Chinese government officials on the restoration of China's position in GATT and was received by Premier Zhao Ziyang. On July 10, 1986, the Chinese government formally applied for the restoration of its status as a contracting party to GATT.

II. GATT and China's Open Policy

Some people ask: Why does China now apply to join GATT? In meeting Mr. Dunkel, Premier Zhao pointed out: "China hopes that its status as a contracting party to GATT will be restored; this is to meet the needs of its open policy."

Since 1979, China has been implementing the basic policy of opening to the outside world. This is a policy decision based on the lessons learned in economic construction over the last thirty years and more. China, as a great country with an ancient civilization, has made outstanding contributions to the world in science, technology, culture, and the arts. For many years China was a semi-colonial and semi-feudal country subjected to imperialist aggression and exploitation; this created in some circles an attitude of blind opposition to everything foreign. After the founding of New China, the country was subjected to economic blockade by the United States and some of its allies and suffered from the perfidy of the USSR; this created tremendous difficulties in China's economic development. As a result, for many years, China placed undue stress on self-reliance and stifled the development of foreign economic relations and trade. This was especially serious during the "Cultural Revolution" and resulted in the backwardness of China's science, technology, and economic development. Since then, China has broken away from the concept of an autarkic economy, and now combines self-reliance with the development of foreign economic relations and trade, so as to speed up the process of modernization. In the eight years since 1979, we have made significant achievements in our open policy. We have established four Special Economic Zones — Shenzhen, Zhuhai, Shantou and Xiamen — and fourteen coastal open cities; promulgated and implemented a series of preferential policies and measures; and registered remarkable success in absorbing foreign capital and importing technology.

As a result of the unswerving implementation of the open policy, China's foreign trade has increased considerably. We have established economic and trade relations with 175 countries and regions in the world and signed trade agreements, including most-favoured nation (MFN) articles, with more than 90 countries, the majority of which are contracting parties to GATT.

In opening to the outside world, China deals with both planned and market economies, with developed and developing countries. In order to further implement the open policy, we hope for a full and all-round participation in the international economic and trade system.

III. The Form and Procedures for China's Participation

There has been much discussion of the procedures and forms for China's participation in GATT. Some people have proposed that we join GATT in accordance with Article 33; some have said that if China demands "restoration" of its status as a contracting party, it might cause many legal and practical problems; still others have argued that in 1950 the Taiwan authorities withdrew from GATT and New China did not participate in GATT's activities for many years after that, which was a tacit acquiescence to the Taiwan authorities' withdrawal.

The position of the Chinese government on this question is quite clear: What China has applied for is the restoration of our status as a contracting party to GATT, not "joining" or "rejoining." This is a question of principle. China is one of the founding members of GATT; this is an historical fact which cannot be altered. After New China was founded in 1949, the Chinese government immediately declared that, with regard to the various treaties, including multilateral treaties, signed by previous regimes, the Chinese government would examine their contents and would then recognize, abolish, revise, or re-conclude them, as appropriate in each case. The Taiwan authorities declared China's "withdrawal" from GATT on March 6, 1950; this act was illegal and null and void, since they had no right to represent China. After China was restored its lawful seat in the United Nations in 1971, our legitimate position in other international organizations and agencies was also restored one after another, including our status in the International Monetary Fund (IMF) and the World Bank Group in 1980. Now, in order to meet the needs of our policy of opening to the outside world, it is only natural that China applies for the restoration of our status as a contracting country to GATT. This is a question that concerns China's sovereignty. The Chinese government absolutely will not agree to take part in GATT by the method of "joining" or "rejoining."

On the other hand, considering that GATT is actually a multilateral trade system that attempts to balance the rights and obligations of the various contracting nations, and considering that during the decades when China's relations with GATT were suspended both sides have undergone tremendous changes, the Chinese government has indicated that China would conduct substantive negotiations on the basis of tariff concessions, with the various contracting nations, and would be prepared to bear obligations commensurate with its economic and trade level.

Some people have argued that during the period when the rela-

tions between China and GATT were suspended, GATT held a number of multilateral trade negotiations, and the tariffs of various contracting nations have declined considerably. During the "Tokyo round" of negotiations, held between 1973-1979, many supplementary amendments were made to the provisions of GATT and the nine-point rules were drawn up. How then can China be accommodated within this changed environment?

China maintains that in handling various problems GATT has always adopted realistic and flexible principles. As long as it proceeds from reality and adopts a forward-looking attitude and flexible principles to handle problems left over from history, it will eventually find reasonable solutions acceptable to all parties.

Some people are not quite clear about why China now proposes to conduct negotiations with the various contracting countries on the basis of reducing and abolishing tariffs. The Chinese government is willing to conduct negotiations on this basis because other contracting nations joined GATT in a similar manner. For example, Yugoslavia and Hungary, because of their economic reforms, both joined GATT on the basis of reducing and abolishing tariffs.

IV. Co-ordination of the Two Systems

In 1979 China began an all-round and deep-going reform of its economic structure, from the countryside to the cities, from production to circulation and distribution, from the method of operation to the government economic management organizations. Through these reforms, great change has taken place in the operational mechanism of the national economy and a lively situation — which had not existed for many years — has emerged in social and economic life. The progress of the reform is manifested mainly in the following five aspects:

(1) The decision-making power of the grassroots economic units has been increased. The biggest defect of the former system was over-centralization. To date, the contract responsibility system in various forms, which links remuneration to output, has been introduced comprehensively in the countryside; the system of state monopoly on the purchase of main farm products has been abolished; and agricultural production is planned more or less in accordance with market demands, through contracts signed with the state. In the cities, an enterprise's responsibility, rights, and interests are clearly defined so that it has a certain amount of autonomy in planning its production, purchasing and marketing, setting prices

for its products, using its funds, arranging its labour force, issuing bonuses, and entering into co-operation and association agreements.

(2) Different forms of ownership and methods of management have evolved. While upholding public ownership as the foundation, China has adopted a series of policies to guide and encourage the development of collective and individual enterprises, while also encouraging the development of Sino-foreign joint ventures, Sino-foreign co-operative enterprises and wholly foreign-owned businesses. Monolithic public ownership has changed into diverse forms of ownership, and enterprise management is contracted or leased to the collective or the individual. This change has played an important role in invigorating the economy, bringing about a thriving market, creating more job opportunities, and improving the convenience of people's daily lives.

(3) The planned commodity economy has developed rapidly, and the law of value has begun to regulate the economy. In the production and circulation fields, China has dramatically reduced the categories and quantities of commodities under the direct control of the mandatory plan, expanded the proportion and scope of market regulation, and revamped the commercial circulation system and the pricing system. So far, the market for farm and sideline products and consumer goods has been basically decontrolled, while a considerable portion of the means of production has also entered the market. A socialist commodity market system has begun to take shape.

(4) The wage system has undergone preliminary reform, and the egalitarian practice of "eating from the same big pot" has begun to change. In state enterprises and organizations, the original single grade wage system has begun to change. A worker's wage is linked to his or her responsibility and productivity. In enterprises, the bonus system has generally been restored. This distribution of bonuses has embodied the principle of distributing "according to one's work." At the same time, some enterprises are experimenting with what is called the "floating system," by which the total amount of wages and bonuses is linked to the enterprise's performance and an individual's contribution.

(5) Municipalities have begun to assume greater economic functions, and the central government's role is being curtailed. State organizations at all levels have begun to separate government administration from enterprise management, to streamline administrative structure, and to delegate power to the lower levels, with the result that the function of state organizations has gradually changed from direct control of production and management to taking the

responsibility for planning, co-ordinating, rendering service, and supervising.

With the in-depth development of the reform of China's domestic economic structure, our foreign trade system is naturally also being revamped. Foreign trade enterprises have become economic entities practising independent management and assuming sole responsibility for profits and loss. China has always attached great importance to the role of tariffs. In May 1951, the Chinese government promulgated and implemented the Provisional Customs Law of the People's Republic of China, the Rules of Customs Import and Export Tax, and the Provisional Regulations for Implementation. By 1985, the law and its accompanying rules and regulations had been revised more than twenty times. Customs duties have always played an important role in regulating import and export and protecting domestic production. Therefore, China's proposal to conduct negotiations with the contracting nations on the basis of reducing and abolishing tariffs is in full accord with the principles of GATT. Generally speaking, the reform of China's economic structure is advancing towards a socialist planned commodity economy. This new economic system can certainly be co-ordinated with the GATT system.

V. The New Round of Multilateral Trade Talks

Immediately after submitting its application for restoring China's status as a contracting nation to GATT, the Chinese government sent a delegation headed by Shen Jueren, the Deputy Minister of MOFERT, to attend the ministerial meeting of GATT held at Punta del Esta in Uruguay in September 1986.

This new round of multilateral trade talks was launched in an environment where trade protectionism was intensifying and the international trade environment was deteriorating. Since the beginning of the 1980s, world economic development has been slow, trade protectionism has intensified, and trade barriers have been set up everywhere, seriously damaging the GATT system and harming the interests of many countries, especially the developing countries. In addition, the growing international trade in services, such as banking, insurance, communications, consultancy, and labour service, requires readjustment of the international regulations. Therefore, a new round of multilateral trade talks to supplement, revise, and strengthen the relevant provisions of GATT has emerged as the common goal of the countries concerned.

The new round of multilateral trade talks embodies the continuing rivalry among various countries for economic rights and

interests in the 1980s. The negotiations' results will exert a major influence on world trade for the remainder of the twentieth century and beyond. China pays great attention to and will take an active part in the new round of multilateral trade talks. With respect to the major issues involved in the negotiations, China takes its own independent attitude and stand:

(1) China agrees that a new round of multilateral trade talks should be held and agrees further that the goal of the new round should be to expand world trade, strengthen and improve the multilateral trade system, and expand the role of GATT.

(2) China believes that the new round should give expression to special policies towards the developing countries, and assure them most-favoured nation (MFN) treatment. China also believes that all countries, the developed countries in particular, should gradually rescind their protectionist measures.

(3) China advocates strengthening the GATT system. The member countries should, in line with GATT's principles of MFN and non-discrimination, reach an all-round understanding on a system of guarantees, with more effective rules for the settlement of disputes, so as to create a stable environment for the development of world trade.

(4) With regard to trade in farm products, China believes that in the new round of negotiation, GATT's rules on trade in farm products should be improved and strengthened, trade in farm products should be incorporated in the GATT system, and existing restrictions and distortions of trade in farm products should be thoroughly changed. Regarding labour service trade, China recognizes the importance of this sector in the economic development of various countries and at the same time stresses the big gap in this field between the developed and developing countries. We believe that it is necessary for the developing countries appropriately to protect their labour service departments in line with their economic and social development targets. In the new round of labour service trade talks, attention should be paid to the special characteristics of this trade, and adequate consideration should be given to the interests of the vast number of developing countries.

China looks squarely at the international economic situation, encourages co-operation and common development, opposes the practice of benefiting oneself at the expense of others, and calls for consideration to be given to the special interests of the developing countries. This is the result of China's implementation of an independent foreign line and our open policy with respect to foreign economic relations and trade.

VI. GATT and Economic Development

Participation in GATT, ever since its establishment after World War II, has always brought both rights and obligations:

(1) By participating in GATT, China can enjoy long-term and stable MFN and national treatment. This means that we will enjoy preferential treatment, such as tariff reductions and other concessions, as already reached by GATT. It means that China's exports will not be discriminated against in the markets of other GATT members.

(2) Taking advantage of the rules established by GATT, we can boycott any act that runs counter to GATT or encroaches upon China's economic interests. Under extraordinary circumstances, China may, taking advantage of GATT's exception articles and articles on exemption from responsibility and with the consent of all contracting nations, free itself from certain commitments to GATT, so as to ensure smooth economic development.

(3) By participating in GATT, China should enjoy the preferential treatment accorded to the developing countries within GATT. China's economic development level is low, and our exports currently account for only 1.3 percent of the world's total exports. In 1985 our per capita national income was RMB 656 yuan (about US $223), still that of a low-income developing country. In our multilateral and bilateral economic relations, China has always been treated as a developing country. For instance, Article 14 of the IMF agreement applies to China as a developing country which exercises foreign exchange control and accepts preferential loans extended by the international financial organizations. In 1984 when China joined the Multi-Fibre Arrangement, we were also granted all the preferential treatment given to the developing countries. It goes without saying that, after China's status as a contracting party is restored, we will also enjoy the status of a developing country within GATT.

(4) By participating in GATT, China can make use of the collective strength of the international community and the contracting countries to strengthen our own negotiating position, solve trade disputes in a just and fair manner, and safeguard our legal interests.

While enjoying the GATT rights, China will also undertake certain obligations. In light of China's current economic development level and its specific conditions, we are ready to undertake mainly the following obligations: first, China is prepared to undertake the obligation of tariff reduction and concession and of conducting substantive negotiations on this issue with the various contracting nations. At the same time, China is now studying the

rules for non-tariff barriers (NTB) reached during the "Tokyo round." When this study is finished, China will decide whether or not to accede to the NTB rules. Second, following GATT's principles, China will grant MFN treatment and national treatment to imports from the GATT nations, so that they may compete with local Chinese products on a fair basis. Third, China will, in accordance with GATT's regulations, promptly publish economic and trade policies, laws, regulations, and materials, increase the transparency of its foreign trade policies, create a good service and trade environment, and guarantee the lawful rights and interests of foreign business people.

It can thus be seen that China's participation in GATT and our observance of the rules of the multilateral international trade system will benefit the economic and trade development of China and other countries as well. It should be noted that China has a vast territory, abundant resources, a large population, and a great market potential. All this provides a broad vista for co-operation. Since we implemented the open policy and introduced the reform of our economic structure, China's economy has undergone profound changes. Our participation in GATT shows our efforts to persistently implement the open policy and indicates that China's unique economic system is compatible with GATT. The restoration of China's status as a contracting nation to GATT will further expand trade relations between China and the GATT member states.

VII. Conclusion

Since China's lawful seat was restored in the United Nations in 1972, we have participated in a number of international organizations and have played a positive role in them. China has always pursued an independent foreign line, actively developing political, economic, and cultural relations with various countries. Since we implemented the open policy in 1978, China has successively joined the IMF, the World Bank and other multilateral economic organizations. At present, we are preparing for the restoration of our status as a contracting nation to GATT and to participate in the new round of multilateral trade talks. This is the natural trend stemming from China's implementation of the open policy and the development of international economic relations.

Today, the developing countries need funds and technology from the developed countries, which, in turn, cannot do without the economic growth of the developing countries, who account for over half of the world's population, land, and resources. China, as the

largest developing country, is willing to further develop international economic and trade co-operative relations and to return to the multilateral trade system with GATT as the centre. It is particularly worthy of note that on the question of restoring China's status as a contracting nation to GATT and our participation in the new round of multilateral trade talks, the Canadian government has given us active co-operation and all-out support, and China is grateful for this. We hope and firmly believe that in the future Sino-Canadian relations of friendship and co-operation will be developed further.

II
Trade with Specific Partners

8

The United States

Ye Qixiang

I. The Pattern of Trade since the Shanghai Communique

During President Nixon's visit to China in February 1972, he and Premier Zhou Enlai signed the famous Shanghai Communique, which emphasized that it would be in the interests of the people of both countries to develop economic relations on the basis of equality and mutual benefit. The two sides also agreed to facilitate the gradual development of bilateral trade. China and the United States thus ended a long period of isolation and confrontation, and the economic and trade doors were once again opened. American business people were invited to attend the Chinese Export Trade Fair at Guangzhou for the first time in the spring of 1972.

The formal establishment of diplomatic relations between China and the United States gave further impetus to the development of bilateral economic and trade relations. When direct Sino-US contacts began in 1972, the value of bilateral trade was very small ($12.88 million), but it grew to $2.40 billion in 1979 and reached $7.43 billion in 1985, which translates into an average annual growth rate between 1979 and 1985 of 20.7 percent. In 1985, the United States was the second largest exporter to China, exceeded only by Japan. In 1986, bilateral trade declined slightly to $7.34 billion.

The rather rapid growth of Sino-US trade in the past several years is primarily attributable to a series of positive measures taken by both governments to promote trade, including several bilateral agreements on trade and economic relations. The trade agreement that was signed on July 7, 1979 and took effect on February 1, 1980 provided that each side would accord the other most-favoured-nation (MFN) status. It also established principles for expanding and co-ordinating bilateral trade. Agreements on shipping, air travel, exhibitions, banking, investment, textiles, and grains have also been concluded.

During his visit to the United States in January 1984, Premier Zhao Ziyang, together with President Reagan, signed the Sino-US Agreement on Co-operation of Industrial Technology. It stressed the importance of technology transfer and of trade in high-tech goods, thus laying a foundation for increasing co-operation in this important area.

In May 1984, State Councillor and former Minister of Foreign

Economic Relations and Trade, Madam Chen Muhua, went to the United States to attend the second annual meeting of the Sino-US Joint Committee on Commerce and Trade. During the visit, a work plan was signed to strengthen co-operation in the fields of metallurgy, telecommunications, electronics and technology transfer, and high-tech products. A few months later, a US trade delegation to China signed a work plan concerning air travel and space exploration. In May 1985 the two governments signed an agreement on fishing off the US coast.

During President Li Xiannian's visit to Washington, D.C. in July 1985, the two countries signed an agreement on the peaceful use of nuclear energy, which took effect on December 30 the same year.

The Sino-US Joint Committee on Commerce and Trade held its fourth annual meeting in May 1986. During the course of the meeting, the two countries signed an agreement of co-operation on telecommunications, science and technology and a work plan to carry out technological co-operation in the machinery industry. The US side also agreed to sponsor two feasibility studies, one on the disposal of hazardous waste and the other on modernizing furnaces in power plants.

All these agreements and plans have contributed to the development of trade between the two countries.

Sino-US trade has developed rapidly, but the total volume is still rather small. In 1985, Sino-US trade only accounted for 1.3 percent of total US foreign trade. The kinds of goods that China sells to the United States are rather limited. Roughly, textiles make up one third of China's exports, crude and refined oil one third, and the remaining third is composed of chemicals, hardware and minerals, light industry products, arts and crafts, animal products, and foods and oils.

Take the crude and refined oil as an example. In 1985 China exported 4.48 million tons of crude oil and 1.33 million tons of refined oil (mostly gasoline). Total value of the exported oil was $1.05 billion. Oil prices took a sharp downturn in the international market in 1986, making it very difficult for China to increase its foreign currency earnings by expanding petroleum exports. In 1986, China exported 5.84 million tons of crude and refined oil to the US, an increase of 0.5 percent over the previous year, but the dollar value was only $445 million, a decrease of 58 percent. According to the regulations of the US Environmental Protection Agency, starting from January 1, 1986, lead content in refined oil must be lower than 0.1 gram per gallon, much lower than the lead content in Chinese refinery products. This too will have a negative impact on China's export of refined oil to the United States.

As for US exports to China, at the beginning they were mostly agricultural and forestry products such as wheat, corn, soy beans, cotton, timber, chemicals, and paper pulp. Gradually included have been large machinery and electronic equipment, such as airplanes, synthetic ammonia equipment, satellite communication receiving equipment, oil extracting and refining equipment, computers and electronic instruments. In 1985, the value of these products reached $1.8 billion, about 40 percent of the total imports from the United States. Nevertheless, agricultural and industrial raw materials still constitute the largest share of total imports.

The potential for Sino-US trade is far from being adequately tapped, especially considering the two countries' populations, resources, production capability and market potential. When meeting US Secretary of the Treasury Baker on May 9, 1986 Premier Zhao Ziyang said that economic and trade relations between China and the United States had witnessed great development in the past, but there was still great potential for development, and that Sino-US trade only accounted for a very small proportion of the total US foreign trade. He also expressed the hope that the United States would import more Chinese goods.

II. Economic Co-operation in Recent Years

In recent years, in addition to trade, Sino-US economic and technological co-operation has also enjoyed rather rapid development on the basis of the principle of mutual benefit and through joint efforts by both sides, as evidenced by joint ventures such as the Great Wall Hotel, Beijing Jeep Company, and Guangmei Food Company; joint production of Otis elevators, Nike shoes, Camel cigarettes, and MD-82 airplanes; joint management of the Qiongzhong Ranch on Hainan Island, Yinle Soda Bottler in Shenzhen, and Huating Sheraton Hotel in Shanghai; and joint production, through countertrade, of chemical disinfectant and textile equipment.

On the whole, Sino-US economic and technological co-operation is satisfactory. First of all, it has developed rather speedily, as shown in the accompanying table:

Year	*Amount Committed During Year (US $ million)*
1979-82	383
1983	478
1984	165
1985	1,152
1986	527

Second, co-operation has taken a variety of forms. There are joint ventures, joint production, joint management and personnel training, as well as technology transfers and the selling of advanced equipment. Third, the range of co-operation has gradually widened. It started from tourism and light industry projects to gradually cover coal, electricity, offshore oil, the excavation and use of nonferrous metals, machinery, electronics, and aviation projects. Fourth, technology transfer has been upgraded. According to the American embassy in Beijing, some large engines, computers, equipment for making advanced integrated circuits, telecommunication equipment, and scientific instruments can be routinely approved for export to China. Fifth, there are more and more medium and big projects. Projects agreed to in 1985 included joint production of twenty-five MD-82 airplanes, joint management of the Antaibao open-pit coal mine at Pingshuo—which is the biggest coal mining project China has undertaken with a foreign country—and joint exploitation of natural gas at Yinggehai. In addition, the Office for Development Planning under the US Agency for International Development and Cooperation has so far sponsored twenty feasibility studies at a cost of over $8 million, some of which have already yielded good economic results.

By the end of 1985, total US direct investment in China committed through agreements exceeded $2.1 billion. Of this sum, $275 million was in joint ventures, $896 million in joint production enterprises, and $958 million in joint exploitation of offshore oil. There are now over 130 Sino-US joint ventures, about 5.7 percent of the total number of joint ventures in China, and more than 100 US companies have set up offices in China. US direct investment in China, both in terms of the dollar amount and the number of enterprises, is second only to Hong Kong and Macao.

Sino-US joint ventures have only had a short history, but they have already yielded good economic results, as the following examples demonstrate:

(1) US companies have found a natural gas field with a reserve of 90 billion cubic meters at Yinggehai in the South China Sea. China and the United States signed a supplemental exploitation agreement in 1985. It is scheduled to begin production in 1990 and will be the first big gas field to be opened since China began international co-operation in exploring for offshore oil in 1979.

(2)The Beijing Jeep Company began production in January 1984. Within two years, it reaped a profit of 86 million RMB ($26.8 million at the then 1:3.2 exchange rate). In October 1986, Chinese and

American shareholders received their first dividends. The latter mailed home $300,000 from Beijing. In the same month, the Beijing Jeep Domestic Content Community came into existence. It is the first horizontal economic entity to be set up by a joint venture. More than eighty companies from various parts of China have signed contracts with the Beijing Jeep Company on ninety-six domesticization projects, through which Chinese-made parts will replace imports. There was almost no domestic content in the Jeep Cherokees at the beginning. Last year the proportion of domestic content reached 12.4 percent and is expected to hit 25 percent this year. By 1990, it will be 54 percent. Moreover, more than thirty Cherokees were exported for the first time last year to five countries in Central America and the Caribbean. About one hundred Cherokees are planned to be exported this year. Between now and 1990, AMC has committed to export $75 million worth of jeeps for the Beijing Jeep Company.

(3) Shanghai Foxboro Company, a manufacturer of industrial automation instruments and systems, began production in April 1983. It has so far produced more than ten kinds of automation instruments, of a quality that satisfies technical standards completely. These instruments have been well received by end-users.

(4) The O-rings produced by the Hubei Pike Sealing Materials Factory have received much praise for overcoming leaks, which have long been a problem in industrial equipment. The economic results have been remarkable since the factory began production two years ago. Value of production per worker exceeds 45,000 RMB, more than any other Chinese company in the same field. Most of its products are for export.

(5) The Antaibao coal mine at Pingshuo has about 500 million tons of reserves of excellent coal. Total investment is $650 million, of which the American investment constitutes one fourth. According to the contract, the period of joint management will be thirty years. Annual production of coal is planned to be 15.3 million tons, most of which will be exported to Japan. The mine is scheduled to begin production in 1987.

As can be seen from these examples, Sino-US economic co-operation has taken encouraging steps. A degree of credibility has been established, and an even better future is expected. However, we should not lose sight of the fact that Sino-US economic and technological co-operation has not yet reached the level both sides hoped for. The scale is not large; the range is not broad. By the end of 1985, US direct investment overseas was $232.68 billion (about 45

percent of the world's total), but US investment in China constitutes less than 1 percent of this figure. The potential for further co-operation is therefore quite large.

III. Major Problems Impeding Further Development

When reviewing and praising past developments, we must also note that the development of Sino-US economic and trade relations has not been plain sailing. We still face a number of difficulties and obstacles that affect the smooth development of bilateral trade and economic co-operation. The major problems at present are as follows.

A. Some US Statutes Are Outdated

There are still various kinds of special statutory provisions regarding China. They have either prevented China from enjoying certain prerogatives it should have or else require China to go through unnecessary and cumbersome procedures. China is a developing country but the United States has not accorded GSP treatment to China's exports (more about this later). MFN status has to be renewed every year, and in ocean shipping China still does not enjoy MFN status. The American side should completely repeal or change those outdated statutory provisions.

B. Continuing Trade Deficits

Because of differences in the method of measuring trade, China and the United States have quite different figures regarding the volume of bilateral trade. But cumulatively from 1972 to 1986, China suffered huge trade deficits, whether based on Chinese or American calculations. According to MOFERT figures, the cumulative trade deficit suffered by China between 1972 and 1985 was $14.86 billion. (By American data, the figure was $7.59 billion.) In each of the three years between 1980 and 1982, China's deficit exceeded $2 billion. It dropped somewhat in the following two years, with 1983 at $620 million and 1984 at $1.36 billion. In 1985, however, the deficit went back up to $2.75 billion, and in 1986, it was still as high as $2.09 billion.

Foreign trade should be a two-way street. In order to balance the international accounts, many countries, especially some Third World countries, require that there should be at least a rough balance between imports and exports. It is not unusual to have deficits for

one or two years. China does not require absolute balance either. The problem, however, is that China has suffered a trade deficit for a long time. Moreover, the deficit is still growing and China is no longer able to afford it. In order to insure a steady growth of Sino-US trade, both sides need to endeavor to solve the problem. China is willing first of all to expand production. We are also willing to work hard to accelerate the construction of bases and plants specializing in producing exports, improve the quality and packaging of products, strengthen transportation ability, guarantee to deliver goods on time, adjust further to the needs of the American market, and develop new products.

At the same time, China hopes that the US government will take a long-term, strategic view when considering Sino-US trade and actively pursue policies that can show results quickly in terms of reducing and eliminating China's deficits. More specifically, we hope that the US government will further open up the market, reduce tariffs, increase quota allotments, eliminate restrictions, and facilitate the importation of those commodities which are of special concern to China. China also hopes that American friends from all walks of life will pay more attention to the question of how to market Chinese goods in America. This is an issue of top importance for developing Sino-US trade.

Balancing the trade is in the economic interests of both sides. Only when America imports more from China can China increase imports from America.

C. Restrictions on Chinese Textile Exports

Textiles are China's biggest export to America. According to US import statistics, China's textile exports to America in 1980 were worth $375 million. By 1985, the value had quadrupled to $1.49 billion. As trade protectionism grows in America, more and more restrictions are being placed on China's traditional exports such as textiles and apparel.

In August 1986, the US House of Representatives tried to override President Reagan's veto of the Textile and Apparel Act of 1985 (the Jenkins' bill). The override attempt failed, because it did not get the required two-thirds majority. Mr. Granger, Chairman of US Association of Fibre, Textiles and Apparel Trade, predicted that after the new Congress began on January 6, 1987, major restrictive bills on textile imports could soon be introduced.

Other American industries and people of insight both within and outside the government have strongly opposed this growing protec-

tionism. Representatives of the new industrial areas in the West played a key role in sustaining President Reagan's veto. They believe that such traditional industrial products as textiles will inevitably decline in the developed countries, and that there is no need to pay the price of government subsidy in order to compete with foreign products. Moreover, economic interdependency exists among all the countries in the world today. Limiting textile imports would inevitably decrease America's industrial exports. One informed estimate suggests that it will cost American consumers $44 billion more in the next five years to buy clothes if a protectionist bill is passed.

With respect to textile trade, the US government not only has multilateral restrictions, but also has resorted to bilateral agreements in limiting imports from other countries. The first Sino-US textile trade agreement (January 1, 1980 to December 31, 1982) imposed restrictions on six categories of textiles. The second textile agreement (January 1, 1983 to December 31, 1987) signed in August 1983 increased the restricted categories to thirty-three, including cotton, wool, man-made fibers, and products made of those materials. Since the second agreement took effect, the United States has proposed nearly sixty more restricted categories which fall outside existing bilateral agreements, expanding the restrictions to cover more than ninety categories. Based on square yardage, more than 90 percent of Chinese textile exports are now under restriction.

On February 19, 1987, the Textile and Apparel Act of 1987 was introduced in Congress. It would impose an overall quota on future textile imports to America and would reduce imports from Asia, Europe, and Canada. The bill also provides that, based on the 1986 figures, the annual growth rate of textile imports in the next ten years must not exceed 1 percent. When the bill was made public, some textile-exporting countries in Europe and Asia and some international organizations strongly opposed it. The International Textiles and Apparel Administration pointed out in a formal statement that the US textile and apparel industry is doing well, that "serious damage" has not really occurred, and that the real purpose of the bill is to freeze and eventually reduce textile imports by inappropriate methods, including the abuse of GATT provisions. If passed, the bill would have a serious impact on Chinese textile exports to America.

The forthcoming negotiations regarding a new agreement on textile trade will be difficult. During his visit to China in late April 1986, US Secretary of Commerce Baldridge made it clear that restrictions have to be put on Chinese textile exports to America. Mr. Donald Foot, International Agreements Director of the Textile and Apparel Office, US Department of Commerce, also said recently

that there were twenty-seven categories of textiles and apparel from China which were banned from entering the United States in 1986, more than from any other country. More categories will be banned in 1987. These restrictions are serious obstacles to the development of Sino-US trade.

D. Continuing US Restrictions on High-Tech Exports

Since 1940, the United States has implemented an exports control policy. It provides that those high-tech products and advanced technologies exported from the United States must not be used for military purposes, nor may they be re-exported to a third country by the importing country.

In order to control the exportation of high-tech products, the US government in 1978 devised a discriminatory method, dividing countries in the world into seven groups and treating each group differently, regarding high-tech exports:

Group T: mostly consisting of countries which traditionally have a friendly relationship with the United States, such as Canada, countries in Central America, South America, and the Caribbean;

Group V: Western European countries, Japan, Australia, New Zealand, and some developing countries in Asia and Africa;

Group S: Libya;

Group Q: Romania;

Group W: Poland and Hungary;

Group Y: USSR, Bulgaria, Czechoslovakia, Lithuania, Latvia, Estonia, Democratic Republic of Germany, Laos, Albania, Mongolia, and China; and

Group Z: Vietnam, Cuba, Cambodia, and North Korea.

On the whole, the United States allows exportation of high-tech products and high-tech transfer to Groups T, V and S. It allows exportation of ordinary goods to Groups W and Y, while placing tough restrictions on exporting those high-tech intensive products and technologies that are military-related or might be diverted to military applications. As for group Z, a total embargo is enforced.

After lengthy discussions, the United States announced in April 1980 that it would put China in a new Group P by itself. In November 1983, China was upgraded from Group P to Group V. The United States divides technologies and products into three zones: Green, Yellow and Red. Exportation of products in the Green Zone needs only routine approval by the Commerce Department. Exportation of those items in the Yellow Zone that involve

high tech must be approved jointly by the Department of Defense and other relevant inter-departmental agencies. Items in the Red Zone involve advanced military equipment and are "extremely unlikely to be exported." In November 1983, the US government published a list of seven categories in the Green Zone over which control would be loosened. Those categories included computers, semi-conductor manufacturing equipment, and electronic instruments. It also promised to do the same with ten more categories in 1984—a promise, however, that it failed to fulfill. The American government stresses that although China is now in Group V, it does not necessarily receive the same kind of treatment as other Group V countries. In its list of controlled products, the United States specifically notes that it retains US national security controls on exports to China and the special approval requirements set by the Paris-based Coordinating Committee (COCOM).

On September 10, 1985, Chairman Deng Xiaoping met Mr. Frank Gilbney, Vice Chairman of the Editorial Board of Encyclopedia Britannica. When Mr. Gibney asked what else the United States should do to further develop US-Chinese economic relations, Deng's answer was that the most important thing was technology transfer from America to China. American business circles are very interested in this; the American administration and Congress should be more interested in it. On October 16, 1985, Vice President Bush announced that the fifteen OECD countries had agreed to liberalize control over the exportation to China of fifty percent of their high-tech products.

On the basis of agreements reached by COCOM, the United States announced towards the end of 1985 its new rules to liberalize restrictions on exports to China. According to those new rules, the United States can, without the approval of COCOM, export twenty-seven categories of products that fall within certain technological parameters, provided that China can produce evidence showing that it is the end user and can guarantee that it will not transfer them to a third country. Those twenty-seven categories of technology products include digital control devices for machine tools, electric cable and fibre-optics producing equipment, electronic component producing and measuring equipment, aviation equipment, communications equipment, gas lasers, electronic measuring equipment, frequency synthetizers, radio-frequency analyzers, microwave equipment, electronic tubes, electronic components, computers and software, communications transforming equipment, analogue to digital and digital to analogue transformers, sound recording or duplicating equipment, oscillographs, quartz crystals and components, and prefabri-

cated fibre-optics. Those new rules have contributed to the shortening of the process by which the United States and other COCOM countries approve exports to China. Other procedures have also been streamlined. The American embassy in China reports that changes in the export control policy have led to an increase in the quantity of equipment exported to China. The number of export licenses to China approved in 1982 was 2,020 with a value of $500 million. It rose to 4,443 worth $2 billion in 1984. In 1985, it again increased to 8,637, amounting to $5.5 billion in value.

The above mentioned new rules, however, deal only with the simplification of the approval procedure and the reduction of approval time. In essence, they have not eliminated restrictions on exports to China. There are still many problems. Further, the simplified procedures are limited to civilian products or products that have dual military and civilian purposes. They are not applicable to military products. It is yet to be seen how much the level of technology exported to China will be raised. What is obvious now is that discriminatory restrictions still exist with respect to exporting technology to China.

E. US Refusal to Grant GSP Status

According to resolutions by the United Nations Conference on Trade and Development (UNCTAD), a system referred to as the Generalized System of Preferences (GSP) should be applied to exports from developing countries to the developed countries. At present, among those Western countries that have adopted GSP, the United States is the only one that refuses to accord China GSP status.

As early as May 1981 when China and the United States were negotiating their trade agreement, China raised the question of GSP and demanded that provisions regarding GSP be included in the trade agreement. But the United States refused to consider GSP, using the pretext that GSP is a unilateral action and therefore should not be touched in a bilateral agreement. At the first meeting of the Sino-US Joint Economic Committee held in September 1980, China once again expressed the hope that since China is a developing country, the United States would solve the GSP problem. This positive suggestion on the part of China, however, did not generate a response from the United States. In the years since, the United States has repeatedly stressed its "statutory requirements," trying to show that China so far has not completely met the conditions for enjoying GSP. The so-called "statutory requirements" refer to the Trade Act

of 1974, according to which the President cannot designate communist countries as beneficiaries of GSP unless such a country enjoys MFN status, has joined GATT and the IMF, and is not under the domination of international communism.

The signing of the Sino-US trade agreement has solved the MFN problem. Besides, China has now joined the IMF. As for the joining of GATT, in recent years, China has been engaged in preparatory work for restoring her status as one of the founders of GATT. On July 10, 1987, the Chinese government made a formal application to GATT. The three principles for restoring China's status in GATT are: (1) China will join GATT by way of restoring her membership (as opposed to temporarily joining or rejoining); (2) China will commit herself to reducing tariffs, but not to increasing the percentage of imports; and (3) China should be treated like a developing country. This application by China has received widespread support at the board meetings of GATT.

The United States imposes no tariffs on goods covered by GSP. It is initially estimated that some 960 kinds of goods that China now exports to the United States would fall under the coverage of GSP. Exports to the United States would be expanded if GSP is granted to China.

When analyzing and studying the issue of Sino-US economic and trade relations, we should praise the results that have been achieved. At the same time, we should not lose sight of the obstacles and difficulties on the road to further co-operation. We think that as long as both sides spare no efforts, work hard to overcome the difficulties, and turn negative factors into positive ones, the future is really bright for the development of Sino-US economic and trade co-operation and technological exchanges.

9

Japan

Ma Chengsan

Japan is a friendly neighbour of China's, and the two peoples have maintained close relations for a long time. Since the founding of the People's Republic of China, the Chinese government and people have attached great importance to developing all types of relations with Japan, including trade relations. Through joint efforts, China and Japan normalized diplomatic relations in September 1972, which laid a sound foundation for the future development of trade. At present, Japan is China's largest trading partner.

I. The Development of Sino-Japanese Trade

Since the founding of New China in October 1949, there has always been some trade between the two countries. In 1950, total Sino-Japanese trade amounted to US $47 million. But because of the outbreak of the Korean War, Japan followed the U.S. policy of blockade and embargo, causing a sharp decline in Sino-Japanese trade. In June 1952, with the active support of the Chinese government and people from all walks of life in Japan, the non-government trade promotion organizations of China and Japan signed the first non-governmental trade agreement. During the period from June 1952 to March 1958, four non-government trade agreements were signed. Therefore the fifties were later called the "Non-Government Trade Agreement Era." In that period, the annual trade value ranged from only a few million to about 100 million US dollars, and the range of commodities traded was also extremely limited.

The sixties were the "Friendly Trade" and "Memorandum Trade Era." In November 1960, the representatives of China and Japan signed a semi-governmental five-year memorandum, in which the overall principles of trade were defined: barter trade, with long-term arrangements, overall balance, and deferred payment. It was then mutually decided that China would export coal, soybeans, corn, bean and peas, salt and tin, and so on, while Japan would export steel, chemical fertilizer, machinery and pesticides. During this period, Sino-Japanese trade expanded from US $100 million to about US $1 billion per annum.

Since the normalization of diplomatic relations between China and Japan in 1972, and especially since China adopted its open

policy in 1978, Sino-Japanese trade has been developing rapidly. According to MOFERT statistics, Sino-Japanese trade (imports plus exports) in 1972 totaled only US $1.04 billion, but increased to US $6.71 billion in 1979 and further increased to US $13.85 billion in 1986. (According to the statistics of the Japanese Ministry of Finance, Sino-Japanese trade totalled US $1.1 billion in 1972, US $6.65 billion in 1979, and US $18.96 billion in 1985.) In the period from 1972 to 1986, Sino-Japanese trade grew faster than China's total foreign trade, with the share rising from 16.5 percent in 1972 to 23.8 percent in 1986. Japan has been China's largest trading partner for many years, while at the same time China is now Japan's second largest trading partner (just behind the United States), accounting for 6.2 percent of Japan's total foreign trade. The year-by-year details of Sino-Japanese trade are shown in Table 9.1 (page 94).

The commodity composition of Sino-Japanese trade at present is as follows: energy and primary commodities account for most of China's exports, while China's imports are mainly machinery, steel, and heavy and chemical industry products. According to the Japanese statistics, fossil fuels had a 45.8 percent share of China's exports in 1985 (with petroleum products 42.9 percent), grain and food 16.0 percent, raw materials 11.2 percent, and manufactured goods 24.7 percent. In the same year, in China's total imports from Japan, heavy and chemical industry products accounted for 91.0 percent (with machinery 57.0 percent and iron and steel 25.6 percent) and textiles and other light industrial commodities 7.1 percent.

II. The Problem of Trade Imbalance

At present, the obvious problem in Sino-Japanese trade is the large deficit on the Chinese side. Since the normalization of diplomatic relations in 1972, China's trade with Japan has almost always been in the red (except in the year of 1982, when China had a surplus of US $1.11 billion). However, before 1983, China's trade deficits with Japan were rather small, averaging less than US $1 billion annually. In 1984, the deficit increased to US $ 2.02 billion, and it jumped to US $5.22 billion in 1985, accounting for 70 percent of China's total current account deficit. China is a developing country; its total exports in 1985 only amounted to US $24 billion. A deficit of such a size is obviously a very serious problem. Therefore, the leaders of China and Japan are quite concerned about the problem. In September 1985, when meeting with a visiting delegation of the Japan-China Economic Association, Deng Xiaoping pointed out: "I hope our Japanese friends will help us by making good suggestions,

Table 9.1
China's Merchandise Trade with Japan
(US$ million)

Year	*Exports to Japan*	*Imports from Japan*	*Total Trade*
1950	21	26	47
1951	1	12	13
1952	3	1	4
1953	7	3	10
1954	21	15	35
1955	58	25	83
1956	65	64	128
1957	60	55	115
1958	33	48	81
1959	0	0	0
1960	0	0	0
1961	22	14	36
1962	33	42	74
1963	65	64	129
1964	141	161	302
1965	192	262	454
1966	269	334	603
1967	234	304	538
1968	205	335	540
1969	201	382	583
1970	224	583	807
1971	281	594	876
1972	412	627	1,039
1973	841	1,107	1,949
1974	1,143	1,983	3,125
1975	1,403	2,392	3,795
1976	1,223	1,817	3,040
1977	1,357	2,109	3,465
1978	1,719	3,105	4,824
1979	2,764	3,944	6,708
1980	4,032	5,169	9,201
1981	4,597	5,381	9,978
1982	4,861	3,900	8,761
1983	4,457	4,620	9,077
1984	5,354	7,374	12,728
1985	5,610	10,830	16,440

SOURCE: MOFERT Yearbook 1986.

facilitate our technical transformation, and make more Chinese commodities accessible to the Japanese and world market; I also hope our Japanese friends, when considering Sino-Japanese trade relations, will not only focus on Japanese commodities for the China market, but also China's exports to Japanese and world markets. Only in this way can the development of the economic and trade relations between the two countries have a bright prospect." In the spring of 1986, Premier Zhao Ziyang suggested to a visiting Japanese delegation, "Joint efforts should be made by both the peoples and governments of the two countries on the principle of equality and mutual benefit. We should also take a positive attitude to gradually solving the problem of the trade deficit between the two countries. I hope the Japanese side will open up their market, relax restrictions, and import more Chinese goods for the benefit of a healthy and continuing development of Sino-Japanese economic and trade relations."

We are very glad to see that, at government level meetings, routine consultation by the foreign ministers of the two countries, and other joint government activities, the Japanese government has shown full understanding of China's concern over the trade deficit issue, and will take positive measures to narrow this trade gap. In April 1986, meeting with Foreign Minister Wu Xueqian, Prime Minister Nakasone noted that the Japanese side is working sincerely to solve the trade imbalance.

A trade promotion delegation from Japan, headed by the Chairman of the Japan-China Economic Association, Mr. Kawai Ryoichi, and consisting of 160 people, visited Beijing in May 1986. They came to discuss issues concerning further development of Sino-Japanese trade and long-term economic and trade co-operation. Both sides agreed that Sino-Japanese economic and trade relations will develop to a higher stage and have a bright future.

III. The Issue of Opening Up the Japanese Market

Solving the problem of imbalanced trade between China and Japan requires joint efforts on both sides. At present, on the Japanese side there are two problems that deserve our immediate attention: (1) various taxes and non-tax barriers that are preventing China from exporting more to Japan need to be removed; and (2) Japanese direct investment in and technology transfer to China needs to be actively increased, so as to enhance China's export capability.

At the moment, Japan's policies of high tariffs, import quotas and the banning of certain products from China are man-made obstacles

preventing further development of Sino-Japanese trade. According to a Chinese survey, Japan's high tariffs are currently affecting at least fourteen types of commodities, for example high quality hand woven carpets, Wu Long, jasmine, and Po Er tea, honey chestnuts, cotton-rubber and leather shoes, gingko, dried persimmon, processed egg products, tinned pork, sweet potato products, and so on. The tariff on honey is as high as 30 percent, and on Wu Long, jasmine and Po Er tea 20 percent (with an additional 5 percent physical goods tax for Wu Long and jasmine tea). Japan imports all three types of tea from China, the tax for which is obviously unfair. China's high quality hand woven carpet is not competing with any Japanese domestic industry, but the tariff has reached 9.6 percent, which is higher than that on other types of carpets. Chestnuts are a native product of China that the Japanese consumers like very much, and they are not used in the same way as Japanese chestnuts are. Again, there is no competition with Japanese domestic industry, yet the tariff is unfortunately as high as 16 percent.

Chinese exports affected by Japanese import quotas include raw silk, edible seaweed, tinned beef, taro chips, peanuts, beans and peas, and tinned pineapple. There are over twenty types of export products that are banned by Japan for quarantine reasons, including rice straw and related products, fresh beef, mutton and pork, fresh tomatoes, green pepper, pumpkin, cucumber, green soya beans, Hami melon, Tianjin pears, litchi, unshelled walnuts, and processed Chinese medicine.

It is the mutual wish of both the Chinese and Japanese units engaged in Sino-Japanese trade that the above man-made obstacles be removed, to allow more Chinese commodities to enter the Japanese market in order to reach a rough balance of trade between the two countries. The Chinese government and some Japanese trading organizations are pressing the Japanese government to adopt a positive attitude to seek solutions to this problem.

IV. The Commodity Composition of China's Exports

Balancing the trade with Japan, or at least keeping the imbalance within certain limits, is an important condition for sustaining Sino-Japanese trade over the long term. There are two ways to reach this goal: one is an active (expansionary) policy; the other is a passive (contractionary) policy. In view of the interests of the two countries, the former is obviously the more ideal method, implying that balance is achieved by expanding Sino-Japanese trade.

According to MOFERT data, from 1979 to 1986, China's exports

to Japan increased from US $2.76 billion to US $4.36 billion, with an annual rate of growth of 6.8 percent. However, this increase is mainly attributable to the rise of China's oil exports in recent years. In the above period, China's export of oil (crude and refined) to Japan increased from US $1.12 billion to US $3.06 billion, with an annual growth rate of 15.4 percent. If we take oil out, China's exports to Japan actually declined by about 20 percent in this period. In 1986, oil (crude and refined) represented 70.4 percent of China's exports to Japan.

Japan is a country that is short of energy and other resources. China's export of oil and other resources on the one hand is undoubtedly mutually beneficial. But on the other hand, this reliance on oil is not conducive to the further development of trade. There are two reasons for this. First, because of the change in Japanese industrial structure, the progress of energy-saving technology, and the slowdown of economic growth in Japan, Japan's market for industrial raw materials, especially oil and other forms of energy, is very sluggish. Second, in recent years, the prices of primary commodities on world markets have fluctuated drastically and shown a tendency to fall. The changes in the price of oil have been particularly great, thus seriously affecting China's foreign exchange earnings.

Japan's main exports are steel and machinery, which are greatly needed by China in its modernization program, while China's main exports are oil and other energy products, which are currently restricted by the market situation in terms of both quantity and price. Hence, China must try to increase export of commodities other than oil.

Of course, the structure of trade between the two countries is determined by their natural resource endowments and their industrial structure, which cannot be changed fundamentally over night. Thus, China should at present adopt a policy of increasing the exports of primary commodities and manufactured goods simultaneously, giving special attention to enlarging the share of the latter. Therefore, China, on the one hand, should continue to develop its oil and other energy exports to Japan according to the Sino-Japanese long-term trade agreement. On the other hand, China should also make special efforts to develop its exports of corn, soya beans and other agricultural products and non-ferrous metals, rare metals and so on—that is, should seek diversification of primary product exports.

In the long-run, it is of strategic significance to develop exports of manufactured goods to Japan. Because China's per capita oil and other energy reserves and output are quite limited, as the economy

grows, China's domestic demand for energy will rise substantially, thus affecting China's future export ability in this regard. At the same time, China's enormous human resources are far from being fully utilized. If China's export of manufactured goods (including semi-finished goods) can be expanded, it will not only help to increase Sino-Japanese trade volume, but also improve the quality of Sino-Japanese trade, changing the current vertical division of labour into a horizontal division of labour.

There are obvious difficulties in changing the commodity composition of exports to Japan, especially in increasing the export of manufactured goods. But there are also favourable conditions. First, this policy conforms with the changes of Japan's own industrial structure and import composition. Japan's industrial structure is evolving gradually toward technology-intensive and knowledge-intensive industries, while labour-intensive and resource-intensive industries are declining. A recent study by the Industrial Bank of Japan identifies more than forty Japanese industries that are losing international competitiveness. As a reflection of this change, Japan's import composition is also changing, with the share of energy and other industrial raw materials becoming smaller while that of manufactured goods is rising. The share of manufactured goods in total Japanese imports was 22.8 percent in 1980, 31 percent in 1985 and 38.3 percent in 1986. Second, as Japanese economic power grows and the pressure from other countries (including developing countries) increases, the Japanese government is now pursuing measures to open up the Japanese market, including reducing tariffs, simplifying import procedures, improving the verification system, and so on. Third, as Chinese economic reform advances and the industrial and agricultural sectors develop, China's export ability will increase both quantitatively and qualitatively, especially for manufactured goods. Fourth, the rise of the yen since the latter part of 1985 constitutes a favourable condition for China to increase its export of manufactured goods to Japan.

In view of the characteristics of the Japanese market (i.e., very high quality requirements and fierce competition) and the current status of China's exports of manufactured goods to Japan, improving product competitiveness, especially non-price competitiveness, will be the key to export growth of manufactured goods.

To solve the above problem, the Chinese government is taking a series of measures. For example:

(1) greater importance is being attached to export of manufactured goods, and measures have been taken to develop production and encourage export;

(2) the problem of the quality of China's export commodities has drawn the attention of both the government and enterprises concerned, which are trying to solve the problem through speeding up technology transformation and improving management;

(3) China has started setting up a production system for export commodities, including many types of export commodity production bases; and

(4) the key to developing new products and improving product quality is to bring the initiative of enterprises into full play. The Chinese government is now adopting a series of fiscal and other policies to encourage enterprises to produce high quality export commodities.

V. The Impact of the High Yen

Since the decision to intervene jointly in the foreign exchange market was adopted at the meeting of five Western finance ministers in late September 1985, the value of the yen against the US dollar has soared, reaching levels above ¥130:US$1 by the latter part of 1987. It is a generally held view that considering Japan's economic power, its huge international balance of payments surplus, the pressure from the US, the changes of world oil prices and other relevant factors, the yen will fluctuate at a relatively high level.

Because the value of the yen has risen so sharply and suddenly, the Japanese economy, especially its export sector, has been hit seriously. According to estimates by the Japanese Economic Planning Agency, the sharp rise of the yen has made a lot of industries uncompetitive in price. Industries included are manufacturers of electrical appliances, automobiles, office equipment, and machines. To offset the negative effects of the high yen, the Japanese government has been pursuing the policy of stimulating domestic demand, rescuing small and medium-sized companies, and facilitating the readjustment of industrial structure. Japanese firms, especially large ones, are struggling to find a way out of the situation by expanding the production of their overseas subsidiaries and importing more spare parts. It is generally thought that whatever the wishes of the Japanese government and business community, the present high yen will inevitably speed up the transformation of Japan's industrial structure toward a higher value added stage (knowledge and technology intensive), and will further encourage the import of manufactured goods (including semi-finished goods) and the expansion of direct investment overseas. In this process, a new 'international division of labour' will be formed between Japan and other countries

and regions, especially those newly developed industrial countries and regions of Asia.

This situation constitutes a very good opportunity for China to expand exports of manufactured goods to Japan. In terms of commodities, at the top of the export list are light and textile industrial goods, for example, clothes, shoes, sporting goods, and art and handicraft goods. In addition, spare parts and general machinery have great export potential. At present, relevant Chinese departments are studying the market carefully and taking measures to improve product quality so as to expand China's export of manufactured goods.

In view of the experiences of other countries and regions of Asia, attracting more foreign direct investment is an important way to increase the export capability of the host country or region. At the time of the high yen, and as more and more Japanese companies adopt a global corporate strategy, how to encourage more Japanese firms to make direct investment in China is an issue concerning both sides. In October 1985, the State Council announced the "Regulations On Encouraging Foreign Investment," which showed our determination to improve the investment environment and attract more foreign direct investment. One outstanding feature of the above regulations is that different treatment has been afforded to different forms of investment. For example, investment in export-oriented enterprises or involving the transfer of advanced technology will enjoy the most favourable treatment. The departments concerned are now seriously applying this new regulation in order to attract more foreign investment in China's export sector and high-tech industries.

10

Western Europe

Liu Youhou

I. History of Trade Relations

A country's foreign trade is always closely related to its overall external relations. With the evolution of international politics and economy in the decades since the founding of the People's Republic of China (PRC), trade relations between China and Western Europe have passed through several stages of development.

A. The Semi-Stagnant 1950s

After the founding of New China, the European countries of Sweden, Denmark, Switzerland, and Finland were among the first to establish diplomatic relations with the People's Republic. Together with Italy, France, Britain, Holland and Belgium, they were the first Western countries to engage in trade with China. The industrial basis of the young People's Republic was then very weak. Most of the equipment, instruments, raw materials, and other important materials needed for restoring and developing the national economy could not be produced locally. Such a state of affairs presented a good oppportunity for Western European companies to develop trade with China, and in fact our trade with those countries was developing at a rapid pace. In 1950, China's exports to Western Europe amounted to $84 million, about 15.2 percent of our total exports that year, while imports from Western Europe were valued at $76 million, or 13.1 percent of China's total imports.

After invading Korea in 1950, the United States imposed an economic blockade and embargo against China. Under pressure from the United States, leaders of some other countries also pursued the policy of blockade, embargo, and trade discrimination with respect to China. Under these restrictions, most high-tech equipment and important strategic materials could not be exported to China. Because of the blockade and embargo pursued by the capitalist countries, we greatly expanded our trade with the Soviet Union and Eastern European countries. At the same time, we continued to try to develop trade with Western Europe and Japan. In the mid-1950s, China's imports from the Soviet Union and Eastern Europe made up 79.9 percent of our total imports, and China's exports to those countries accounted for 68.4 percent of our total exports. China's trade with Western European countries plummeted. In 1952, trade

with Western Europe only accounted for 3.5 percent of our foreign trade. The situation in 1953 and 1954 was also semi-stagnant. Faced with such a reality, business circles in Western European countries began to realize that they had made a mistake, so they demanded that the embargo list be changed. During the Geneva Conference in 1954, China sent a trade delegation to Britain. Business people and bankers in Belgium, Italy, and Holland organized their own committees for trade with China and sent delegations to Geneva. Business circles in France, Switzerland, the Federal Republic of Germany, and Norway also expressed their hope to send delegations to China. Norway, Britain, and Holland soon resumed diplomatic relations with China, and pursued trade opportunities, American opposition notwithstanding. After 1954, trade between China and Western European countries (especially, Britain, France, the Federal Republic of Germany, and Switzerland) increased significantly, although, because of the embargo, trade volume was still rather small even at the end of the 1950s. In 1959, trade with Western Europe amounted to 14.8 percent of our total foreign trade.

B. Rapid Development in the 1960s

Sino-Soviet relations deteriorated seriously toward the end of the 1950s. In 1960, the Soviet Union perfidiously and unilaterally tore up its agreements and ended co-operation with the People's Republic. Under Soviet influence, the Eastern European countries also curtailed their trade with China, with the result that trade with the Soviet Union and Eastern Europe declined from 60 percent of our total foreign trade in 1960 to 10 percent in 1969.

China then turned its primary attention to Western Europe and other Western countries, trying hard to make our exports meet the needs of these markets in terms of quality, specifications, and variety. In terms of imports, with Chairman Mao Zedong's approval, Premier Zhou Enlai personally took charge of the work in 1962 to import a vinylon production line from Japan, thus breaking the American-enforced embargo. In 1963, China also imported from France the technology and equipment to produce butyloctanol, which set the precedent for importing new technology and complete sets of equipment from Western countries. In 1964, General de Gaulle showed great insight in deciding to recognize the People's Republic of China, an event which had repercussions throughout the world. China then imported quite smoothly the patented French technology to produce Berliet trucks. After that, we imported from Western Europe a variety of technology and equipment in the fields of oil, chemicals, metallurgy, mining, electronics and precision

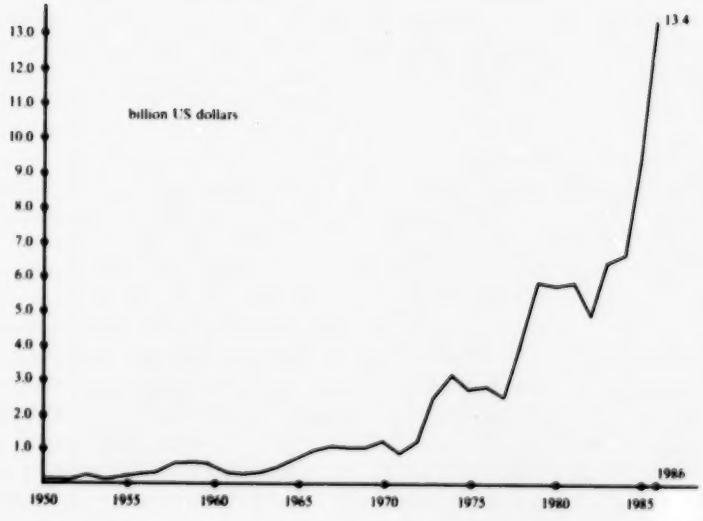
machinery. During the 1960s, our trade with Western Europe expanded rapidly, at an average annual rate of 8.2 percent, while our total trade volume was growing at only 1.9 percent per year.

C. The 1970s and 1980s: Comprehensive Development

In the beginning of the 1970s, several important events occurred in China's foreign trade. President Nixon's visit to the People's Republic restored trade with the United States, ending an interruption of more than twenty years. The establishment of diplomatic relations between China and Japan led to a new development era of Sino-Japanese trade at both official and unofficial levels. As trade with the United States and Japan developed, and contacts with the Soviet Union and Eastern Europe gradually revived, the geographic distribution of China's trade became much more diversified, and Western Europe's share declined substantially, although the absolute value continued to rise as shown in Figure 10.1, reaching US $13.35 billion in 1986.

It should be stressed that trade with the European Economic Community (EEC) is of utmost importance. In 1975, China and the

Figure 10.1
Changes in the Value of China's Trade with Western Europe
(US$ billion)



EEC established formal relations, followed by a long-term trade agreement (1978) and the first trade agreement on textiles (1979). Since 1980, the Community has granted GSP status to some of China's exports. China has also signed co-operation agreements with some EEC countries on trademarks, ocean shipping, air travel, patent co-operation, investment protection, and the avoidance of double taxation. Because of rapid development, the original trade agreement became outdated. Through friendly consultation and on the basis of preserving the basic provisions in the original agreement, Mr. Zheng Tuobin, the MOFERT Minister, formally signed the "Agreement on Trade and Economic and Technological Co-operation between the PRC and EEC" during his visit to the EEC in May 1985. According to EEC statistics, trade value between China and EEC countries increased from 1.82 billion European Currency Units (ECU) in 1975 to 10.5 billion in 1985, an average annual growth rate of 19.2 percent. Trade with China as a percent of the EEC's total external trade rose from 0.75 percent to 1.34.

II. Problems in Sino-Western European Trade

However, the level of trade between China and Western Europe is still very low and has lagged behind the good bilateral political relations. In 1985, China was only responsible for 1.0 percent of the EEC's imports and 1.9 percent of its exports. Also, there has been a serious imbalance in the development of trade, as evidenced by the fact that China has suffered trade deficits for more than thirty years. From 1970 to 1985, the cumulative trade deficit was $16 billion. In 1985, only 35.9 percent of China's imports from Western Europe was compensated by exports to Western Europe. At the same time, the growth has not been very stable. In particular, China's imports have fluctuated widely.

There are a variety of reasons for the above problems. On the Chinese side, the first problem is that the structure of China's exports is relatively backward and has not adapted to the rapid changes in the Western European market. Chinese industry is still rather backward. Light industry products and textiles are the major items among China's export of manufactured goods (80 percent). The percentage of chemical products and machinery is very small. The export of such consumer durables as television sets and other household appliances has just begun. Three-quarters of China's exports to Western Europe are accounted for by vegetable plant oil, rice, frozen rabbit meat, dried vegetables, canned fruits and vegetables, feed grain, tea, casings, bristles, perfume oil, rosin, feather products,

carpets, furs and fur products, goatskin, gunny-bags, cotton cloth, cotton knitware, apparel, filature silk, gasoline and refined oil, chemical products, medicine, tungsten ore, tools, leather products, embroidery, and special arts and crafts. The Western European market for these products is close to saturation. On the other hand, China has difficulty exporting machinery, transportation equipment and other high-tech products whose proportion in Western Europe's imports is rising.

Second, Europe's markets are extremely competitive, and the quality of China's exports has often been inadequate. They are still medium or low-grade goods, and lack variety. Fashions are outdated and the packaging is poor. Some products have remained exactly the same for dozens of years and have been squeezed out of the market. Some exports are plentiful in supply and meet European market requirements, but because of inflexible business practices by Chinese exporting companies, (e.g., the minimum order is too large), plus late deliveries, their competitiveness is weakened.

What must be mentioned in particular is the growing trade protectionism in Western European countries. Since the early 1970s, all sorts of non-tariff barriers have been erected. Products whose importation is under restriction have extended from agricultural products and textiles at the beginning to iron and steel products, machine tools, popular electronic products, semi-conductors, automobiles and other manufactured products.

In the Chinese market, Japan and the United States, though latecomers compared with Western Europe, have quickly caught up. Furthermore, there are greater fluctuations in Western Europe's exports to China. All this is primarily attributable to the relative lack of competitiveness of Western European products in the Chinese market.

Of course, not all Western European products are uncompetitive with the United States and Japan. But generally speaking, the United States and Japan excel in high-tech and new manufacturing industries. Moreover, the rise of the so-called newly industrialized countries and areas such as Singapore, South Korea, Taiwan, Hong Kong, and Brazil has removed the advantages enjoyed by Western Europe in traditional industries.

The following are the major areas where Western Europe is not so competitive in the Chinese market. First of all, prices are not competitive. Production costs in these countries are relatively high, adversely affecting their exports. This is also evidenced by the continuing existence and gradual growth of the EEC's trade deficits with the United States and Japan.

In negotiating with China, some Western European firms have made tactical mistakes, which have cost them the opportunity to expand exports to China. Three years ago, a PhD candidate from France studied dozens of Western European firms' experiences in trading with China. He then wrote in a paper, "since the Chinese side often asks the seller to reduce prices so as to show friendship, exporting firms should leave enough room for this when quoting their initial prices." During negotiations, he added, "do not easily agree to lowering prices." These views have spread and among some companies they are as sacred as the Bible. However, these tactics are exactly why Western European goods have not flourished in China so far. Most Chinese imports are subject to state planning. The buyers and the users hope to buy more and better equipment and technology with limited foreign currency. Therefore, they will make inquiries with many potential sellers, compare the prices and quality, and choose the better and cheaper goods. But Western European firms often give a price at the beginning which is much higher than what is reasonable. Some even double the reasonable price. This inevitably affects Chinese confidence in making deals.

Second, Western European business circles do not attach due importance to the Chinese market. They lack initiative, aggressiveness, and a long-term perspective. The number of their offices in China is only about one-third that of Japanese offices. Japanese companies send some of their best staff to work in China, some of whom are real China hands. As former British Prime Minister Edward Heath said not long ago, the Japanese understand the psychology of Chinese buyers and users, and they are good at collecting market information and understanding new trends. By contrast, people working for Western European firms in China usually are not among their best and brightest. They do not study the Chinese market thoroughly. Lack of information and slow reactions to China's market trends have cost them many opportunities. Western European entrepreneurs tend to be conservative and stubborn. They lack the flexibility of the Japanese and the adventuresomeness of the Americans.

Further, some Western European entrepreneurs believe that it is all up to the leaders of the People's Republic to decide what China buys and where to buy it. Therefore, they pay great attention to sending their senior executives to accompany their heads of state or government to visit China so that they can contact the top leaders. On the other hand, they do not aim their advertising at the many professionals in the foreign trade business, nor the potential users. In this regard, Japanese firms do a much better job. "International

Economic and Trade News," run by MOFERT, is the Chinese professional paper in external trade; it carries more foreign ads than any other paper. It has great influence among the cadres at various levels, foreign trade companies, and factories and mines. Western European firms do not use this medium enough. In terms of space or frequency of ads carried by this paper, none of the Western European countries can compete with Japan. When planning to import a certain product, therefore, many Chinese buyers and users think first of all of Japanese firms.

Western European entrepreneurs and governments only pursue deals involving large amounts of money. For a very long period of time, they took as their major objective to export large, complete sets of equipment, while neglecting to market small products and some raw materials and consumer goods (e.g., packaging materials and household electronics). As a result, when fewer big projects are imported from Western Europe, medium and small projects cannot make up the difference, resulting in the big fluctuations in the value of trade.

III. Prospects for the Development of Sino-Western European Trade

Despite the rise of competitors like the United States and Japan in recent years, Western Europe still occupies a very important position in the world economy, in trade, science, and technology. All kinds of industries can be found here, and technologically each country has its advantages. Aerospace, machinery, chemicals, civil nuclear power, automobiles, railroad transport, metallurgy, and telecommunications—all these industries are well developed. Electronic data processing, while starting later than in the United States and Japan, still enjoys certain advantages. There are a great many medium and small businesses in Western Europe; their unique technology and scientific management methods are relatively easier to adapt to Chinese conditions.

There are, however, two points that deserve the attention of Western European countries. First, Western Europe should move quickly to change the existing discriminatory restrictions on exporting technologies to China. It should be borne in mind that the world situation has changed greatly in the past thirty years, yet the Paris-based Coordinating Committee (COCOM) still restricts the flow of technology to China. It has become an obstacle for the further development of normal trade and economic and technological co-operation between our country and Western Europe. Second, Western European firms should strengthen their studies of the

Chinese market, give reasonable price quotes, combine the export of equipment with technology transfers, and combine exports to China with imports from China. Governments should provide help with loans and credits. Only thus can Western Europe occupy an important share of the huge market that China will be.

China is now trying to achieve the Four Modernizations. We hope that Western European countries and especially the EEC will provide some monetary assistance and send more experts here to offer technology consultation, so that China will produce more and better products that meet the needs of the market. At the same time, we hope that Western European countries will loosen controls, open the market more, and let in more Chinese exports. Considering that we have suffered deficits with Western Europe for a long time, the latter should give priority to increasing imports from China. We also hope that Western Europe will take China as the developing country that we are, eliminate all sorts of restrictions on our products, and grant comprehensive GSP status, so that bilateral trade will develop healthily on a balanced basis.

Economically, China and Western Europe have their own advantages and disadvantages. To combine each other's advantages will compensate for each other's disadvantages. China is big and rich in natural resources. In particular, there is a large reserve of minerals and coal. Western Europe, on the other hand, lacks these resources. To secure the supply of raw materials and energy, Western Europe is pursuing a diversified trade policy and has a stong desire to cooperate with China in this regard. The European Parliament in April 1984 prepared a report on "Economic and Trade Relations between the EEC and PRC." According to this report, China is a reliable long-term supplier of rare metals and coal to Western Europe. Because of the lack of transport facilities, our export of coal to Western Europe remained stagnant for a long time, but recent transport improvements mean that China's coal exports can be increased many-fold in the 1990s. With respect to nonferrous metals and other raw materials, China and Western European countries can sign long-term supply contracts.

At present, China has to develop technology at various levels. Apart from one or two scientific and technological fields where we have caught up with the world's development, China is still very backward, and we need to strengthen our co-operation with Western European countries. On the other hand, we also need to greatly expand our traditional industries. In Western Europe, many traditional industries like textiles, shipbuilding, and metallurgy have become "sunset" industries. Some of the disused technology and

equipment in those industries could play an important role in China.

In a word, the prospects are broad for the development of Sino-Western European trade. We believe that, through joint efforts by both sides, Western Europe's share in China's total foreign trade will reach 18-20 percent before the end of the century.

11

The Soviet Union and Eastern Europe

Chen Longzhou

Since the first government-to-government barter trade and payments agreement was signed in the early 1950s, China has maintained bilateral trade relations with the Soviet Union and Eastern European countries.*

During the 1950s, this trade experienced a period of vigourous growth, with the volume accounting for a large share in China's foreign trade. The hundreds of large and small complete sets of equipment and other mechanical products and the industrial raw materials we imported from the Soviet Union and Eastern Europe played a great role in speeding up China's socialist economic construction. At the same time, we exported to these countries a lot of key industrial materials and minerals, as well as consumer goods like foodstuffs and light and textile industrial products. Such trade ties were weakened later, due to changes in the historical conditions, and the trade volume fell drastically. In recent years, however, China's economic and trade relations with these countries have been expanding dramatically, and personnel contacts increase day by day.

I. Trade Policies

Since 1949, economic and trade relations with the Soviet Union and Eastern European countries have been developing on the basis of equality and mutual benefit, according to the requirements and possibilities on both sides. Expanding these ties is not only our common aspiration but is objectively possible with favourable conditions. These countries have camparatively well developed economies, each enjoying its own strong points in production technology, so each has something that China can make use of. China possesses rich resources and an immense labour force. Our agricultural and sideline products, native and animal products, metals and minerals, light and textile industrial products and certain kinds of machinery and equipment are exactly what the Soviet Union and Eastern European countries are in need of. Therefore, both sides can exchange commodities and learn from the other's

* Albania is not included in this article.

strong points. At present, China's strategic priorities for national economic construction are exploiting energy, upgrading transport and communication facilities, and accelerating technological transformation of existing enterprises, with a focus on the improvement of product quality, reduction of energy consumption, and saving of raw materials. With these strategic goals, China has explored ways to expand economic and trade relations with these countries, and has reached specific agreement with many of them.

Since China began the open policy in 1978, more attention has been paid to the absorption of whatever is useful from abroad to accelerate our economic construction on the basis of self-reliance. It is impossible for a country to make quick advances in economy and technology without developing international economic co-operation. Therefore, China's open policy is world-oriented, applicable not only to the developed countries and developing countries but to the socialist countries as well. Practice shows that the development of economic and trade ties with the Soviet Union and Eastern European countries has played the anticipated role in deepening mutual understanding, consolidating the traditional friendship between the peoples of China and these countries, and boosting socialist construction in all of them.

II. Trade Volume and Share

The development of trade relations with the USSR and Eastern European countries has experienced a history of ups and downs. The 1950s saw a big increase but the 1960s a steep decline. Relations resumed in the 1970s, and a new leaf has been turned in the 1980s.

In 1950 a small trade volume, valued at US $338 million with the Soviet Union and about US $23 million with Eastern Europe, was recorded. Later, China signed barter trade and payments agreements with these countries. In 1953, the Chinese and Soviet governments signed treaties establishing the fundamental principles to govern trade and shipping between the two nations. In addition, General Conditions for Delivery of Commodities were set forth between China and the Soviet Union and Eastern European countries respectively. Bilateral trade thereupon expanded smoothly until 1959, when a record high in value was reached, topping US $2.1 billion with the USSR and US $720 million with Eastern Europe. At the peak, trade with these countries accounted for 74 percent of China's total trade volume.

In the 1960s, however, trade fell drastically; the volume with the Soviet Union declined to a low of scarcely US $47 million in 1970, less than one percent of total trade, while trade with Eastern Europe

dropped to a low of US $140 million in 1964. Trade between China and Eastern Europe recovered gradually after 1965, while only in the 1970s did Sino-Soviet trade bounce back, reaching a value of US $490 million in 1979.

In the 1980s trade volume has continued to grow, although there have been one or two slow years. Particularly noteworthy are the long-term trade agreements for 1986-1990 China signed with these countries in 1985. Under these agreements trade volume for the second five years of the decade is estimated to double compared to the first five. Judging by developments to date, these targets can be attained. In the last few years, trading corporations of both sides have signed agreements on the supply of specific commodities for the next five or ten years, such as the Five-Year Steel Agreement signed with Yugoslavia.

As of 1985, however, trade with the USSR and Eastern Europe together still accounted for only 6.5 percent of total trade. From this point of view, there is still great potential for further expansion of trade between China and these countries. (Further details of the volume and composition of trade are given in Tables 11.1 and 11.2, page 114.)

III. Relations with Specific Countries

After China's trade with the Eastern European countries declined in the early 1960s, it revived first with Romania. Sino-Romanian trade reached US $700 million by 1966, and witnessed continuous expansion, nurtured through reciprocal exhibitions and visits during the 1970s. A Mixed Trade Committee was set up in 1975, followed by the establishment in 1978 of the Economic and Technical Cooperation Committee. Starting from that year, China and Romania opened new areas for co-operation, and in 1979 Sino-Romanian trade again reached a record high, US $1.09 billion. Since the 1960s trade with Romania has ranked first compared with other Eastern European countries, and still retains that position to date.

China and Yugoslavia signed a trade and payments agreement in 1956, thus initiating economic and trade relations with each other. However, it was only in the 1970s that such relations really developed. During that period, party and state leaders exchanged visits many times, and a great number of delegations, business groups, experts and study groups visited each other and exchanged an immense amount of information and materials. In order to keep up with the continuing long-term growth of economic and trade contacts, the

two countries set up a Sino-Yugoslavia Economic, Scientific and Technical Cooperation Committee at the Vice Premier level in 1978. Trade between the two countries is conducted in convertible currencies, which is helpful to other Eastern European countries, but methods such as barter trade and compensation trade are also utilized.

As early as 1950 China and the Democratic Republic of Germany signed their first barter trade and payments agreement and have maintained bilateral trade relations ever since. During the 1950s, each was the second largest trade partner to the other. After a decline in the early 1960s, trade resumed and developed further. Bilateral co-operation took a new form at the end of 1983, when the government leaders exchanged visits. Further, in 1984 and 1985, the two governments signed an agreement on long-term economic co-operation and a barter trade and payments agreement for the 1986-1990 period. In addition, the two governments set up committees on economic, trade, scientific, and technical co-operation.

In 1985 China's trade with Poland, Hungary, and Czechoslovakia reached record levels. Trade with Czechoslovakia now exceeds that with the Democratic Republic of Germany, and is second only to Romania among the Eastern European countries.

Sino-Soviet trade underwent big fluctuations, but has been growing quite rapidly during the 1980s. At present, in terms of the share in China's foreign trade, the Soviet Union ranks fifth, after Japan, the Hong Kong and Macao region, the United States, and the Federal Republic of Germany.

IV. The Commodity Structure of Trade

In the 1950s China's imports from the Soviet Union and East European countries were mostly means of production, various types of machinery and complete sets of equipment, instruments, and so on. For instance, machinery accounted for 62.6 percent of China's imports from the Soviet Union in 1959. China's exports to these countries consisted largely of raw materials and agricultural and sideline products as well as native produce, of which cereals, edible oils, and foodstuffs made up the largest proportion.

In the 1960s, there was a drastic decline in China's importation of complete sets of equipment. Another notable change was that after 1965 China no longer imported oil products from the Soviet Union, but instead exported oil to Eastern Europe. Simultaneously, China's exports of cereals, edible oils, and non-ferrous metals also declined dramatically.

Trade as a whole took an upward trend in the 1970s. Light industrial products—textiles in particular—gradually took a larger share, whereas there was a big reduction in cereals, edible oils, and foodstuffs. Manufactured goods were added to China's exports to the Soviet Union. Regarding imports from the Eastern European countries, complete sets of equipment declined in importance. However, China continued to import heavy-duty vehicles, machine

Table 11.1
China's Trade with the Soviet Union and Eastern Europe
(US$ million)

Year	*USSR*	*Eastern Europe*
1950-59	13,074	4,290
1960-69	5,210	2,612
1970-79	2,978	10,363
1980-85	4,732	11,037

SOURCE: China Foreign Trade Yearbooks for 1984-86.

Table 11.2
Soviet and Eastern European Shares of China's Total Foreign Trade, Selected Years
(%)

Year	*USSR*	*Eastern Europe*
1950	29.7	2.1
1955	56.9	17.4
1960	43.6	15.9
1965	9.5	4.8
1970	1.0	7.6
1975	2.0	7.0
1980	1.3	6.6
1985	3.1	3.7

SOURCE: China Foreign Trade Yearbooks for 1984-86.

tools, excavators, mobile cranes, marine diesels, diesel-powered generators, 10,000 DWT ships, and so on. A moderate increase was reported in the import of raw materials and semi-finished products.

As a result of the readjustment of the national economy in the early 1980s, China curtailed the import of mechanical and electrical products and instruments, while increasing that of raw and semi-finished materials. Due to the limited supply of such materials in the Eastern European countries, China's trade volume with them dropped to some extent. Later, however, imports of mechanical and electrical products and instruments went up again. Major items China imported from these countries in the period included steel products, plate glass, soda ash, caustic soda, nonferrous metals, vehicles, coal mining equipment, drilling machines, and production lines for canned beverages. Imports from the Soviet Union included civilian aircraft, heavy-duty vehicles, farming machines, coal mining equipment, geological exploration equipment, textile machinery, steel sheets, steel tubes, timber, cement, plate glass, urea and others.

As far as China's exports are concerned, textiles occupied a rather large proportion, including cotton clothing, silks and satins, knitware, embroidery, bedding, towels, and so on. Other exports were native and animal products, cereals, edible oils, and foodstuffs such as rice, soybeans, corn, and groundnuts. What merits special mention is that Chinese-made colour television sets, transistor radios, and tape recorders, as well as other electronic products, began to build a presence in some Eastern European countries. According to the 1986-1990 long-term trade agreements with these countries, China will export more lathes, measuring and cutting tools, hand tools, small farming machines, telecommunication facilities, bicycle parts, stainless steel flatware, hardware, and so forth. In the 1980s China exported four ocean-going ships to Czechoslovakia for the first time.

V. Methods of Trade

Apart from the traditional trade on account, trade between China and the Soviet Union and Eastern European countries in the 1980s has been diversifying into barter trade, trade in convertible currencies, loan-based trade, entrepot trade, and compensation trade.

(1) Trade on account: According to a barter trade and payments agreement or a yearly barter trade protocol signed between the two governments, each side opens an account with the other, and all trade payments are settled through the depository bank. Except for trade with Yugoslavia, the currency for pricing and account clearing

used before 1970 was the Russian rouble. After 1970, this was changed to the Swiss franc. Generally, import orders on both sides are kept in balance each year. Later, a yearly permissible difference —or swing limit—was set forth, with interest at an agreed rate calculated on the balance exceeding the swing limit. Prices are fixed on the basis of historic prices, but since 1970, for those goods that were not exchanged before, prices are determined in light of sales contracts and with reference to prices prevailing on world markets.

(2) Barter trade: This is a new pattern of trade that has developed in recent years. It is also settled through a clearing account. With the approval of MOFERT, foreign trade corporations may barter commodities item by item on a reciprocal basis or by way of importing goods to raise the buyer's export capacity according to the pattern set forth by the trade agreement. For example, when the China National Machinery Import and Export Corp. signed a vehicle import contract with the All-Soviet Union Car Export Company, agreement was reached that China should supply car storage batteries to the Soviet Union. China exchanges cotton, cotton knitted articles, tires and other things for Polish steel sheets and mini-buses, and exchanges fibres, embroidery, tablecloths and other handicrafts for Yugoslavian furniture.

Barter trade is also conducted between the Chinese Ministry of Commerce and the Romanian Ministry of External Trade, and the credit co-operatives of both countries do similar trading. While guaranteeing the supply of goods as set forth in the government-to-government trade agreement and in the foreign trade plan of the central government, provinces and municipalities concerned may swap local products for necessary machinery, or barter those items that are not covered in the central plan in a bid to promote export production and achieve a balance between import and export. The practice is that each of the provinces and municipalities is allowed to open its own bank account and to be responsible for its own profits and losses. Heilongjiang province and Shanghai are barter trade partners to Czechoslovakia and Poland respectively.

(3) Trade in convertible currencies: China's trade with Yugoslavia was conducted on account before 1969, but was changed to convertible currencies in that year. This arrangement has caused some problems, as the trade corporations only try to sell domestic products for more convertible currencies. With countries other than Yugoslavia, trade on account is still the principal form, but some trade in convertible currencies has been carried out in recent years. It takes the same form as that adopted between China and the Western industrial countries and other developing nations, namely payment

made under letter of credit. Faced with a serious shortage of foreign exchange, however, the Eastern European countries are extremely cautious in undertaking convertible currency trade.

(4) Entrepot trade: China can adopt this method in a bid to enlarge contracted value when our imports exceed exports with the Eastern European countries.

(5) Compensation trade: A case in point is the trade agreement signed in 1980 between China and Yugoslavia, which calls for Yugoslavia to supply US $200 million worth of Yugoslav coal coking and other equipment in exchange for 600,000-800,000 tons of Chinese coal annually for several years.

(6) Border trade: This refers to trade between Northeast China, Inner Mongolia, Xinjiang, and other provinces and autonomous regions on the one side and the bordering Soviet regions, autonomous states, and republics on the other. The total value of such trade for 1983-85 reached 140 million Swiss francs. As provided for in the notes exchanged in 1986, border trade may be conducted between the Xinjiang Uighur Autonomous Region and five of the bordering Soviet republics and districts. This type of trade is carried out by the provinces and autonomous regions, which tap sources of supply and settle accounts independently of the central government. In addition, there are small amounts of non-governmental purchases and sales of means of production and daily necessities between the peoples along the border. According to China's policies of opening to the outside world and enlivening the domestic economy, small amounts of border trading are allowed for the purpose of invigorating the border economy, better satisfying the requirements of the people, and deepening the friendship and contacts along the border.

VI. Economic and Technical Co-operation

After three years of rehabilitation of our national economy, we started our First Five-Year Plan in 1953, thus entering the era of large-scale socialist construction in a planned way. During this period, China's major imports were complete sets of equipment from the Soviet Union and Eastern Europe. During the 1950s we signed contracts with the Soviet Union on complete sets of equipment for 304 projects and 64 individual workshops and devices, of which 149 and 29 respectively were fully or basically completed. These projects laid down a foundation for our industrial development. The Soviet Union provided loans of Rbl.7.6 billion to China for the importation of the technology and equipment in question, and these loans plus the accrued interest were repaid fully by 1964,

one year ahead of schedule. During the 1950s, China also imported thirty-seven complete sets of equipment and twelve hundred individual machines from the Democratic Republic of Germany. German experts gave active support to China in the development of various industries, such as chemical, heavy machine building, machine tool making, electricity and gas, building materials, and open-pit coal mining. At the same time many professionals were trained for China. Imports from Poland included equipment for sugar refineries, electric power stations, coal washing, and plywood processing. In addition, Hungary provided certain equipment to China in the 1950s and 1960s. Imports from the six Eastern European countries in the 1960s included 108 items in complete sets and 82 items as individual machines.

Thereafter, except for Romania and Yugoslavia, economic and technical co-operation was suspended for more than twenty years. The last few years have, however, seen a rapid growth in such co-operation between China and these countries, in the areas of economy, trade, science and technology.

In his 1984 visit to the Democratic Republic of Germany, Poland, Hungary, Bulgaria, and Czechoslovakia, Zhu Rongji, vice-chairman of China's State Economic Commission, reached agreement with these countries on seventy-nine projects for co-operation and twenty-two for exploration. These projects have to do with light industry, foods, textiles, and mechanical and electronics industries. Arrangement was made with the Democratic Republic of Germany for co-operative transformation of over forty Chinese enterprises, and agreements were reached with Poland jointly to produce combines, edible oil refining equipment, bread production lines, slaughtering equipment, etc. Items to be upgraded jointly with Hungary include large buses, coal washing plants, light bulb production lines, bread production lines, fruit juice packing lines, etc. Technical co-operation with Bulgaria pertains to production of storage batteries and engine-powered forklifts, canned beer and other beverage production lines, technological revamping of starch factories, fruit juice production lines, and so on. Czechoslovakia will join forces with China to produce textile machinery, equipment sets for tanneries, and enamel electrostatic spraying machines.

During his July 1985 visit to the Soviet Union, Vice Premier Yao Yilin signed the Economic and Technical Cooperation Agreement on Construction and Renovation of Industrial Projects, in addition to the long-term Trade Agreement for 1986-1990. These agreements cover technology upgrading in a number of industrial sectors such as

electricity, ferrous and nonferrous metallurgy, machine building, coal mining, chemicals, transportation, and textiles.

At present, production and technical co-operation between China and the Eastern European countries takes various flexible forms as follows:

(1) Mutual supply of complete sets of equipment: For instance, China provides a match production line to Romania, which in return supplies a furniture production line to China. Another example is that the Democratic Republic of Germany offers China technology for the production of kiln equipment, while China grants that country the license for production know-how for refining gadolinium and also supplies the yttrium ore. While supplying complete sets of equipment, both sides provide each other with project designs, technical know-how about production, accessory equipment and part of the raw and semi-finished materials for trial production. Each side also trains personnel for the other.

(2) Assembling of supplied components: Romania provides components to be assembled into Roman brand cars in China, and in exchange China sells watch parts to Romania for assembling. Another example is that refrigerators are assembled on a production line in China, with parts supplied by Romania.

(3) Supply of equipment for upgrading enterprises: China sells to Romania forging equipment, cigarette machines, and vitamin production equipment, as well as various machine tools. Hungary participates in the technological transformation of China's bus and household appliance factories; Poland supplies China with excavating and safety equipment to upgrade Chinese open-pit mines and mining machinery plants.

(4) Exchange of accessory items: Yugoslavia provides China with silicon-controlled rectifiers, thyristors, magnetic heads, etc. Technical know-how is exchanged between China and the Democratic Republic of Germany for the production of light-sensitive and magnetic-recording materials.

(5) Introduction of production technology: China introduces from Poland technology for the production of ferro-magnetic cores, and seeks Poland's consultancy services on fire extinguishing for the Datong Coal Mine. China and Hungary offer each other technical co-operation in providing light bulb production lines, fodder processing equipment, and light socket production equipment.

(6) Production co-operation and joint research: China and Yugoslavia have through joint research developed hexafluoride ceramic high-voltage circuit-breakers, which are up to world standards.

Also, the two countries have jointly produced a new type of carbon dioxide-free welder, which uses less electricity and is smaller but more efficient than traditional arc welders. China also joins hands to make combines with the Democratic Republic of Germany, passenger cars with Poland, and machine tools with Hungary.

(7) Co-operation in other sectors:

(a) Labour services: In May 1986 China and the Democratic Republic of Germany signed an agreement in principle on the training of Chinese workers by the German side. China is to send in 1987 our first group of workers to receive training and to work in the railway factories of the Democratic Republic of Germany. In 1985 China Metallurgical Construction Co. and Czechoslovakia Technology Export Co. signed their first contract on co-operation in providing labour services in Iraq.

(b) Transportation: As early as 1950 China and Poland set up the China-Poland Ocean Shipping Co., which was renamed the China-Poland Ship Co. Ltd. in 1977. It carries most of the cargo exchanged between the two countries, as well as part of China's imports from Hungary and Czechoslovakia. In April 1986 Czechoslovakia suggested that the China-Czechoslovakia Ocean Shipping Co. be reorganized; the matter is currently under discussion. China and the Democratic Republic of Germany have explored the possibility of signing an air and sea navigation agreement.

VII. Prospects for Future Development

Looking back over the developments of the last few years in the economic, trade, scientific, and technical co-operation between China and the Soviet Union and Eastern European countries, we feel gratified. In the future, China and the Soviet Union and Eastern European countries enjoy wide prospects for still closer co-operation. There is great potential to be tapped, since the scale is not large enough nor are the methods sufficiently diversified. Greater concerted efforts are required to open up wider areas and new channels so that economic and trade relations between the two sides can develop consistently and steadily. The following issues should be solved through common efforts:

(1) Gradually improve the commodity structure: Since China instituted its policies of opening to the outside world and enlivening the domestic economy, positive efforts have been made to expand foreign trade and absorb advanced technology from abroad. With the growth of the national economy and the higher industrial level, there will certainly be a rise in China's production and export

volume of mechanical and electrical products, and a corresponding restructuring of export commodities on both sides.

(2) Make prices more rational and competitive: As both sides carry out their reforms, the problems of price and quality become more apparent in barter trade. As China carries out its open policy, the Soviet Union and Eastern European countries will meet challenges in the Chinese market from capitalist corporations in relation to prices, delivery conditions, and technology. This reality must be faced. As far as China's exports are concerned, more effort must be made to raise the quality and technical levels of the products.

(3) Apply more diversified and flexible forms: The simple, rigid forms of trade that were adopted in the past can no longer keep up with the expansion of economic and trade co-operation. Trade must be diversified in form and expanded in scope through multi-tier channels. Some progress has been made in this respect. Apart from trade under government-to-government agreements and barter trade of individual items, both sides have begun to use other forms, such as processing with supplied materials and against supplied designs, sales on commission, sales by underwritten or agent contracts, and sales at exhibits and fairs. In the areas of production and technical co-operation, apart from technology transfer, supply of equipment and technical services, personnel training and consultancy services, other forms are also in wide use. These forms include joint ventures, co-operative management and exploitation, project construction, labour service co-operation, co-operative production in a third country and joint marketing of products. Only by diversifying the forms of international trade and economic and technical co-operation, can the potential of development be fully tapped.

12

The Third World

Pang Rongqian

As a socialist developing country, China belongs to the Third World. After undergoing similar experiences to those of other Third World countries, we face common tasks. Since the founding of the People's Republic, China has been developing friendly relations with other Third World countries despite the turbulent political and economic situation in the world.

I. Common Demands

The Third World now embraces almost 130 countries, taking up two-thirds of the globe in both population and land. It is strategically important, with abundant resources. Most of the Third World countries won independence after World War II and are making persistent efforts to consolidate their national independence and develop their national economies. Third World countries are therefore the fundamental forces to oppose hegemonism and to safeguard world peace. As these countries capture a larger and larger share in the world economy and trade, China's trade ties within the Third World will continue to be of great importance politically and economically.

Although China has not joined any regional organizations or the "Group of 77," we consider ourselves to be a member of the Third World, and we have been firm in promoting unity and co-operation and in defending the common interests of member nations. In handling many issues connected with the world economy and trade, China takes a firm stand on the side of Third World countries, thereby reinforcing the position of the Third World in the South-North dialogue.

Reinforcing economic and trade ties with other Third World countries is conducive to boosting China's socialist modernization drive. For China's Four Modernizations, two sorts of resources, domestic and overseas shall be utilized; two markets, domestic and overseas must be tapped; and two kinds of capability must be trained, to organize domestic construction and to develop economic relations with other countries. It is China's basic long-term policy to carry out this strategy and open the country to the outside world. As part of this open policy we need to increase exchanges and co-

operation with other developing countries. Economically, Third World countries are comparatively backward, yet they are becoming stronger in world trade. According to IMF statistics, during the 1970-1985 period, the exports of Third World countries (including socialist developing countries) increased from US $65 billion to US $510.3 billion, with their share of total world exports rising from 22.7 percent to 28.4 percent; the imports multiplied to US $522.9 billion from US $ 71.88 billion, with their share of the world total rising to 27.5 percent from 23.9 percent. Moreover, Third World countries are extremely numerous, and each enjoys special conditions and advantages. Some of them with abundant resources export a lot of things that have been in short supply in China for many years, such as rubber, timber, sylvite, iron ore, diamonds, and natural soda. Others can supply us with useful advanced technology and equipment, and still others can sell us high-quality and low-price consumer goods. Although a very large economy, China cannot possibly produce everything we need. According to the principle of comparative advantage, it is necessary that we import some capital and consumer goods from abroad.

In their turn, other Third World countries also attach great importance to expanding trade with the People's Republic of China. With one-fourth of the world population, China is a vast potential market. Persistently adhering to the trade principle of "equality and mutual benefit," China enjoys a fine reputation in the world. Seriously affected by the economic crisis prevailing in the capitalist world early in the 1980's, the economies of many Third World countries were in difficulty, with the economic growth rate declining and trade conditions worsening. The rise of protectionism in the developed nations, in particular, has set up higher and higher barriers against Third World exports. Under such circumstances, it has become ever more imperative to look for markets and outlets within the Third World. Therefore, Third World countries positively enter into negotiations with developed countries for equal and fair treatment, make joint efforts to strengthen unity among themselves, and promote South-South co-operation. At the same time, they give more attention to consolidating economic and trade ties with China, a major member of the Third World.

II. Trade Development

As early as the 1950s, China established diplomatic relations with a number of newly independent countries and started trade with other Third World countries. Shortly after the founding of the People's

Republic, China concluded a rice and rubber barter agreement with Sri Lanka (then Ceylon), marking a breakthrough in coping with imperialist embargo. With the development of foreign relations thereafter, China's trade with other Third World countries has gradually expanded. The 1970s saw faster steps towards unity and co-operation among developing countries. For example, the Organization of Petroleum Exporting Countries (OPEC) proved itself a great force in the joint struggle in the world economy and trade, with oil as a weapon. China resumed its legitimate seat in the United Nations and established diplomatic relations with more countries. During that period, the number of Third World countries and regions setting up trade ties with China exceeded one hundred. Late in the seventies, China began its policy of opening to the outside world. This opens wider areas for economic and trade exchanges between China and other developing countries. China set forth a four-point programme to govern the expansion of its economic co-operation with other Third World countries, namely: equality and mutual benefit, emphasis on actual results, diversity in forms, and common progress. On this basis, China maintains economic and trade relations with 140 developing countries.

Since 1949, China's trade with other Third World countries has been increasing in volume. According to MOFERT data, the total value of imports and exports between China and other Third World countries in 1950 was merely US $151 million, of which China's exports were only US $18 million, while imports were US $133 million. The value for 1970 climbed to US $1.043 billion, of which exports and imports reached US $ 681 million and US $362 million respectively. After 1970, China's trade with the Third World expanded even faster. The figure for 1980 reached US $6.81 billion, of which exports amounted to US $3.90 billion and imports US $2.91 billion. With exports at US $6.23 billion and imports at US $3.26 billion, 1986 witnessed a record high of US $9.49 billion. As can be seen from the data, China enjoyed a trade surplus with the Third World in most of these years.

It merits clarification that all these statistics exclude trade between China and Hongkong and Macao. Naturally, part of China's exports to both regions were re-exported to other Third World countries, but itemized figures are not available.

China's export commodities to other Third World countries include mainly foodstuffs, light and textile industrial products, native and animal products, petro-chemicals, and small amounts of machinery. Classified in light of the international trade standards, manufactured goods account for about 56 percent, of which textiles

and garments each make up roughly one-half, while foodstuffs account for 17 percent or so. Things China imports from the Third World largely comprise agricultural and mineral primary products.

In terms of geography, China's Third World trade partners in the 1950s were concentrated in the Asian region. With the development of the national liberation movement after the sixties, when newly independent countries emerged one after another, wider and wider areas were opened up for China's trade. At present, we maintain direct or indirect trade links with most developing countries. However, trade is not equally developed with all regions. For example, of the 1985 trade, 72.0 percent was done with Asia, 6.4 percent with Africa, 21.0 percent with Latin-America and only 0.4 percent with Australasia.

In Asia, the trade value for 1985 with the six ASEAN countries reached US $3.27 billion, accounting for 34.6 percent of China's total trade with other Third World countries. Of the amount, US $2.28 billion, or 24.2 percent was with Singapore. Trade for 1985 with western Asian countries amounted to US $1.98 billion, or 21.0 percent of our total trade with the Third World. Among those countries a few, such as Iran, Turkey, Jordan, Iraq, Saudi Arabia, and Kuwait, held the larger share. In addition, the Democratic People's Republic of Korea and Pakistan both enjoy a considerable trade volume with China. China exports a variety of commodities to Asian countries, including foodstuffs, light and textile industrial products, native and animal products, petro-chemicals, machinery, and so on. Its imports include various materials like rubber, timber, coconut oil, raw sugar, copper, iron ore, rice, and tobacco, and manufactured goods such as chemical fertilizers, farm chemicals, electronic parts, chemical fibres and plywood.

In Africa there are over fifty countries trading with China. Those in the north such as Algeria, Tunisia, Morocco, Egypt, and Libya have more trade, although Zaire and Zimbabwe also maintain important trade ties with the People's Republic. Regarding the commodities traded, China's exports to Africa include not only light and textile industrial products and agricultural and sideline products, but various kinds of tools, farming instruments and machinery. Our imports include chemical fertilizer, farm chemicals, copper, cotton, timber, cocoa, coffee, and cashews. In the last few years, China's trade with African countries has stagnated or even declined. The annual levels for 1980-1982 topped US $1.1 billion, but trade dropped to US $921 million in 1983 and further declined to US $628 million in 1985, of which China's exports and imports accounted for US $419 million and US $209 million respectively. This is largely due

to the fact that African countries have been badly hit by the economic crisis in the capitalist world, which has made their economic problems still more difficult.

The trade volume in the 1950s between China and Latin American countries was insignificant. It grew very fast in the sixties, although in the main it was limited to Cuba. Following the establishment of diplomatic relations with the major Latin American countries in the 1970s, we have developed trade with them in all sectors. The trade value for 1979 reached US $1.26 billion and further increased during the eighties, when China began to institute the open policy. The total trade value reported in 1985 was US $1.97 billion, of which exports were worth US $695 million and imports US $1.27 billion. Major imports from Latin-America include refined copper, copper concentrate, zinc, iron ore, aluminium, steel, wheat, fish powder, sugar, timber, pulp, and plastic materials. China's exports to that region include rice, paraffin wax, crude oil, and rosin as well as light and textile industrial products, machinery, hardware, and chemicals. China now maintains trade contacts with forty countries and regions in Latin America, among which Brazil, Argentina, Cuba, Chile, Mexico, the Bahamas, Peru and Uruguay occupy the larger share. Since the 1970s, Latin America has been increasing its share in China's trade with the Third World, and imports in particular have increased faster than before. For years, China has been in trade deficit with the Latin American countries.

III. Problems

To sum up the foregoing, although China's trade with other Third World countries has been growing continuously over the past thirty years or more, it is still rather small in scale. The value for 1985 accounted for only 0.9 percent of the total trade of the developing countries as a whole. This shows that there is great potential in the markets of Third World countries, and it is well worth trading with them. Although in the fifties and sixties China's trade with other Third World countries kept increasing as a share of our imports and exports, it fluctuated around 20 percent during the seventies, and has even fallen to some extent in recent years. During the 1982-1985 period, the percentage went down from 21.6 percent to 15.7 percent, with exports declining from 27.1 percent to 23.8 percent and imports from 14.6 percent to 9.5 percent.

Facing China's trade with other Third World countries are some problems or difficulties to be solved by both sides through joint efforts:

(1) Unbalanced Development: Although China maintains trade ties with 140 countries and regions in the Third World, yet development is unbalanced—that is, the trade volume is concentrated on a small number of major partners. In 1985, for example, the trade volume between China and its ten largest partners reached US $5.59 billion, making up 59.2 percent of the total of our trade with the Third World. These ten are Singapore, Brazil, North Korea, Malaysia, Argentina, Cuba, the Philippines, Thailand, Pakistan, and Iran. The other 130 countries and regions shared the remaining 40.8 percent. Except for the ten major partners, China's trade with the majority of Third World countries and regions is rather small. The major reason is that on the one hand our export goods cannot meet their needs either in quality or in quantity, and on the other hand, many of these countries face a severe shortage of foreign currency, while some impose unduly tight exchange controls and high tariffs. Due to limited output, they cannot supply what is needed by China.

(2) China's Big Surplus: For many years, China has enjoyed a trade surplus with other Third World countries. Despite the increasing scope of trade in recent years, the basic situation has not changed yet; on the contrary, our trade surplus tends to grow. The surplus for 1970 was US $319 million. It shot up to US $990 million in 1980, and reached US $2.97 billion in 1986. Such an unbalanced situation is mainly due to the irrational structure of imports and exports between both sides. For China, means of production including machinery and raw materials for industrial production have been accounting for 80 percent or more of the total value of our imports, while means of livelihood have been merely 20 percent. As circumstances would have it, other Third World countries are rather weak in commodity supply; the result is that China's imports from them cannot grow fast enough. Of course, the unbalanced situation is not the same in all regions. Generally speaking, China enjoys a large trade surplus with Asian and African countries, but a deficit with Latin American countries. This is because we import from the latter a large quantity of raw materials—such as copper, iron ore, steel, zinc, and timber. On top of that, we import from these countries quite a large amount of wheat and dried fish. On the other hand, China's exports to Latin American countries have grown rather slowly. The key to the solution of this issue is to make greater efforts to increase our imports from them.

(3) Limited Variety: There is only a small variety of goods for import and export between China and most other Third World countries, particularly with certain African and Latin American

countries. Admittedly, this situation is partly attributable to the commodities produced by both sides. However, the more important explanation is that trade ties were established only recently, mutual contacts are infrequent because of long distance geographically, each side lacks knowledge of the other, and trading channels are not streamlined. As a result, a lot of commodities are not exchanged as they should be. Under these circumstances, the trade departments on both sides should further strengthen mutual understanding and co-operation, making common efforts to tap more varieties of exchangeable goods.

IV. Favourable Factors

A lot of difficulties exist in China's trade with other Third World countries. As mentioned above, however, our economic and trade relations with other Third World countries are something entirely new and are based on equality. It is a common aspiration and demand of both sides to further expand such relations. There are actually a great number of favourable factors which should gradually be brought into play.

Nine years have elapsed since China started the open policy. This policy has given great impetus to the development of our economy, particularly our foreign economic and trade relations. China's exports multiplied to US $27.00 billion in 1986, compared to US $9.75 billion in 1978; our imports tripled to US $32.75 billion from US $10.89 billion in the same period. Simultaneously, the capitalist economies suffered a serious crisis with trade declining; trade between the developed countries and most developing countries was sluggish under prevailing protectionism, so the international conditions can be said to be unfavourable. In spite of that, China's economy and trade still grew steadily and fast. We will continue our open policy over the long term, and step by step enhance our export capability, while greatly raising our ability to pay for imports. This is most attractive to the rest of the world, including other Third World countries. It merits mention here that in 1986 the Chinese government granted approval for the setting up of several regional trading corporations dealing solely with the Third World. They are the China-Gulf Trading Company, China-African Trading Company, and China-Latin American Trading Company. These three companies will actively pursue economic and trade activities in various forms with the above-mentioned regions. For convenience of contact, they plan to set up offices or branches abroad. The

establishment of these companies can be regarded as a practical step that China has taken for further expansion of our trade within the Third World.

Achievements have been and will continue to be scored in the adjustment of the economies of Third World countries. Since the start of the 1980s, in the world economy there have appeared many factors unfavorable to Third World countries. The major ones include: price decline for primary products, protectionism, soaring interest rates, serious drought in Africa, and chaos caused by endless war. All these have led to a drastic fall of export income and weakened capability of import for Third World countries. In order to cope with this situation, the developing countries have taken a series of economic measures to rectify their mistakes in strategy and policy for development. For instance, some countries have lowered their growth rate by curtailing investment, especially in large-scale projects that expect low economic efficiency; some pay more attention to agricultural production; some institute privatization or otherwise restructure government enterprises; and some countries relax policy restrictions that kept them isolated from other nations. In addition, quite a number of countries are developing their processing industry so as to rely less on the exportation of primary products. Some countries and regions, having already reached a certain level in science and technology, try to speed up the development of high technology. All these adjustment measures have yielded some results in overcoming current difficulties. According to the World Bank's estimate, Third World countries will continue to develop at a higher growth rate than the developed countries in the coming ten years. Growth rates during the 1985-1995 period are estimated at 4.7 percent for the developing countries and 2.5 percent for the developed ones. This is, of course, beneficial to the trade co-operation between China and other Third World countries.

South-South co-operation is being consolidated, and both sides will become ever more active in expanding mutual trade. Third World countries have made great efforts to alter the old international economic relations. However, the South-North dialogue overall has come to a stalemate, due to the opposition to the structural reform of the world economic system and refusal to make essential concessions by a small group of developed countries like the United States. Developing countries are seeking increased South-South co-operation, and organizations have been formed one after another for regional production co-operation and exportation of raw and semi-finished materials. In May 1985 developing countries began official negotiations in Uruguay on the establishment of a global preferential

trade system. Under such circumstances, China and other Third World countries have naturally shown greater concern for expansion of their economic and trade co-operation.

V. Desirable Measures

In China's trade with other Third World countries, exports and imports must generally be conducted so as to achieve a balance for the long-term and stable growth on both sides. To this end, we cannot passively cut down our exports to, but must actively increase imports from, other Third World countries. For this, mutual contacts and understanding must first of all be promoted, and new tradeable commodities must be developed through joint efforts, while maintaining what is currently traded. Some exports of other Third World countries available at present, such as timber, pulp, rubber, wool, fish powder, copper, and iron ore are things that China needs to import for a long time to come. Although a considerable share of such imports already comes from various Third World countries, in the future such imports must still be expanded. Since the seventies, the Persian Gulf countries have made remarkable headway in the petro-chemical industry; we can therefore import more fertilizers and petro-chemicals from them. China enjoys a certain supply of mineral reserves like iron ore and chromite, but the grade is low and exploitation is costly, with poor economic returns, so importing of supplies is necessary. Further, China can also buy some machinery and technology from developing countries with a better industrial basis. As for the suppliers in the Third World, more efforts must of course be made to upgrade the quality of their products and improve their management so that their products can be more competitive.

One of the most pressing problems currently facing Third World countries is the shortage of foreign exchange and difficulty of payment. As a developing country, China will also have insufficient foreign exchange for many years to come. In order to solve this problem, more diversified patterns of trade—such as barter trade, compensation trade, triangular trade and entrepot trade—can be adopted in a flexible way. Barter trade and other forms should not and cannot replace normal trading in convertible currency. They can, however, be complementary to the general pattern. In this sense, the adoption of flexible forms of trade actually means enhancing one's ability to pay.

Over the past thirty years and more, China has provided economic aid to more than seventy Asian and African countries and regions,

aid mainly in the form of complete sets of equipment, contractual construction of communications and transport projects, and so forth. The completed projects now number over one thousand. Since the open policy was instituted, economic co-operation between China and other Third World countries has embarked onto a new stage. Great headway has been made in new forms of co-operation like undertaking construction of projects, supplying labour services, and running co-operative enterprises. In the meantime, business people from more and more Third World countries also come to China to make investments and undertake contractual construction of projects and supply of labour services. In the past, however, it was often the case that trade and other forms of economic co-operation between both sides were separated, each proceeding in its own way. In order to reap comprehensive economic results, trade and all other forms of economic co-operation should be organically combined through overall planning. All forms of economic co-operation can encourage the expansion of trade, and trade can in turn boost economic co-operation of other forms.

In trading with China, some Third World countries have special requirements—for instance, some request that more business be conducted with their state-owned enterprises; some request that insurance be placed with their state-owned insurance companies; some require certificates of commodity inspection; some order only small amounts of goods; some demand that invoices or commodity labels be written in the local language; some insist on deferred payment; some even demand payment for imports made 180 days after shipment. Regarding these requirements, the Chinese side should give due consideration to satisfying them in light of the principle of equality and mutual benefit and according to internationally accepted practices. On the other hand, Third World countries should also deepen their understanding of China and have more knowledge of its demand structure, consumption patterns, trading channels, and relevant regulations so that they can better suit that market. Only in this way can other products squeeze into the Chinese market amidst the fierce competition from their suppliers.

All in all, there is a solid foundation for the trade between China and other Third World countries. This can be attributed to the joint efforts made by the governments, trade departments, and other people concerned. Some existing issues can be settled. With sustained growth of the national economy on both sides and subsequent expansion of trade, there will be gratifying prospects.

13

Canada

K. Lorne Brownsey

I. Evolution of Trade Relations

There is a long history of trade between Canada and China. The first reported commercial contact was in the early 1700s when settlers of New France shipped locally harvested ginseng to China. By the late 1700s a brisk trade in furs and lumber existed and the beginnings of corporate and financial links were established. These developments were facilitated by the completion of the Canadian Pacific Railway in 1885 and the establishment of the Canadian Pacific Steamship route to East Asia in 1886.[1] However, significant expansion of this early trade was impeded by the internal strife that engulfed China for the last half of the nineteenth century and the first half of the twentieth century.

With the cessation of World War II and the civil war between Chinese Communist and Nationalist forces, China was able to exert its national sovereignty and pursue an independent foreign policy, including trade relations. China's economic structures were in need of massive reconstruction and it relied heavily on the Soviet Union for assistance. From 1952-1960 China imported large amounts of Russian equipment and technology. During this period, there was some trade between Canada and China, but the bulk of China's foreign trade was with Communist bloc nations. In the early 1960s a major political rift developed between China and Russia and the amount of trade between the two countries declined dramatically. China began to look elsewhere for trading partners and by 1962 its trade with the west exceeded that with communist countries. This year also marked the beginning of large scale grain exports from Canada to China. Three successive crop failures had forced China to seek foreign supplies of grain and Canadian wheat sales skyrocketed from CDN $186,000 in 1960 to over CDN $147 million in 1962.[2]

In 1966 the Cultural Revolution ushered in another major change in China's foreign policy. Domestic politics espoused self-reliance and foreign trade subsequently dropped off. Despite this overall

[1] See L. J. Kavic, "Canada and Asia: Evolving Awareness and Deepening Links," *Pacific Affairs*, XLV, (1972-73), p. 522.

[2] Unless otherwise noted, Statistics Canada is the source of the trade statistics presented in this paper.

decline, Canadian wheat sales remained strong as grain shortages in China continued.

With the end of the Cultural Revolution, China assigned a much higher priority to foreign trade with the West. At the same time, the Trudeau government's 1970 Foreign Policy Review acknowledged the growing economic and political importance of China and East Asia. Shortly afterwards, Canada became one of the first western nations to establish formal diplomatic recognition of the People's Republic of China (PRC).

For a short period in the mid-1970s the Gang of Four attempted once again to steer China on an autarkic course. This reversal was short-lived however, and since 1976 the government of the PRC has looked to foreign involvement as a necessary element in the country's economic development. Zhou Enlai's call for the Four Modernizations and the objective of quadrupling domestic production by the year 2000 have both highlighted the need for greater foreign trade, which has grown rapidly. Sino-Canadian trade has benefited from this expansion. Volume has increased and there is a wider range of commodities exchanged between the two countries.

II. Overview

Canada-China merchandise trade has expanded significantly. In the last fifteen years there has been a fourfold growth in the value of Canadian exports to China, rising from a 1972 level of CDN $260.7 million to over $1.1 billion in 1986. The expansion of China's exports to Canada has been even more impressive. In 1972 Canada's imports from China amounted to CDN $48.4 million. By 1986 this figure has climbed to CDN $566.6 million, more than an elevenfold increase (see Figure 13.1, p. 130).

Throughout this period the balance of trade has remained decidedly in Canada's favour. In 1983 it reached a high of CDN $1.3 billion. Since then Canada's trade surplus with China has shrunk and in 1986 it stood at CDN $533.7 million. This decline reflects reduced Canadian wheat exports and the sale of more Chinese goods in Canadian markets.

Although the volume of Canada/China bilateral trade is considerable, it is not a major component of either country's multilateral trade. In 1986 China's total imports amounted to CDN $45.5 billion of which Canada's share was 2.4 percent. For the same year, China's exports were CDN $37.5 billion, with 1.5 percent destined for Canada. A similar situation exists in Canada's overall trade picture. Canada's 1986 worldwide imports totalled CDN $112.7

billion and exports CDN $120.5 billion. China's share of this trade amounted to 0.5 percent and 0.9 percent respectively.

Canadian exports to the PRC have been dominated by the sale of wheat. It has accounted for 57.6 percent of total exports since 1972. But this dominance is decreasing and in 1986 wheat accounted for only 32 percent of total exports. Commodities such as pulp, paper, aluminium, nickel, fertilizer, and a variety of manufactured goods now occupy a larger share. On the import side, China's exports to Canada have been primarily foods, beverages, household furnishings, textiles and apparel.

Although merchandise trade is clearly the major vehicle for economic exchange between China and Canada, it is by no means the only one. The long term solution to China's economic underdevelopment is not simply to import what it cannot produce. China is anxious to effect a technical transformation of its economic structure. Therefore, joint ventures and technology transfer agreements are key components of its development strategy and a number of Canadian companies have entered into such arrangements. The

Figure 13.1
Canada's Exports and Imports with the PRC
(CDN $ billion)

export of services is another important means by which Canadian expertise and technology are transferred to the PRC.

The Canadian government has also identified China as a focus country for its bilateral aid program. The Canadian International Development Agency (CIDA) has had its China budget for the next five years increased to CDN $200 million, which will make Canada one of the top three aid donors to China.

III. Exports

A. Agricultural products

Agricultural products have traditionally accounted for the bulk of Canada's exports to China. By far the single most important agricultural product that Canada exports to China is wheat. In 1986 Canadian wheat sales to China were valued at CDN $353.47 million. In the past, the importance of wheat exports was even more pronounced. From 1962 to 1972 wheat sales, on an annual basis, averaged close to 95 percent of total exports. Since 1972 its share of all Canadian exports bound for the PRC has exceeded 57 percent.

The value of Canadian wheat exported to China reached a record high of CDN $916.94 million in 1983. However, three years later sales had dropped dramatically to CDN $353.47 million. This decline is largely attributable to record crops that enabled China to become a net exporter of grain. However, it appears that China's demand for imported grain is again growing. Drought in Northern China and the widespread switching by farmers from grain to more profitable crops, suggest that China will return to being a net importer of grain. The level of grain imports for 1987 is expected to be double that of 1986.[3] Canadian wheat sales in the current year have reflected this expectation, and for the first six months amounted to CDN $299.14 million.

Another important agricultural export is fertilizer. China's shortage of arable land demands a high per acre yield, which in turn demands the application of large amounts of fertilizer. Although organic fertilizers are widely used, chemical varieties are also required. This is particularly true of potassium and phosphate fertilizers which are in short domestic supply. In 1986 Canadian fertilizer exports to China amounted to CDN $23.05 million. The outlook for export growth of this commodity is positive. The Saskatchewan firm of Canpotex recently signed a CDN $42 million (500,000 tonnes) potash deal with

[3] Robert Thompson, "China expected to double grain imports this year as production problems are conceded," *The Globe and Mail*, August 28, 1987, B15.

China[4] and in the first half of 1987 total exports of fertilizer exceeded CDN $50 million.

A number of initiatives have recently been taken by Canadian governments to increase the level of China's agricultural technology and management skills. CIDA assistance to China has emphasized the technological transformation of China's agricultural sector. Through its involvement in projects like the Harbin Domestic Animal Breeding Centre, CIDA been instrumental in such developments as the upgrading of animal husbandry technology. "Other [CIDA] projects to be carried out include the introduction of modern seed processing techniques, animal quarantine facility improvements and the upgrading of two agricultural training institutions in China."[5] Provincial governments have also been active in this area. The Quebec government is seeking to establish a large dairy project in Shanxi province and the British Columbia government has signed two agreements with Chinese authorities, one of which is concerned with dairy farming, while the other deals with grassland cattle grazing.[6] Although these initiatives do not guarantee direct sales of Canadian goods, they do have an export generating effect. The goodwill derived from such programs, as well as the exposure to Canadian technology by Chinese personnel, will contribute to growth in Canada's export trade with the PRC. For example, CIDA's participation in the Harbin Domestic Animal Breeding Centre played an important role in bringing about Semex Canada's recent sale of bovine semen.

B. Forest products

Owing to the inadequacy of its timber reserves and the necessity of concentrating reforestation efforts on redressing the severe ecological damage (flooding, erosion, desertification, and wind damage to agricultural crops) caused by deforestation, China's forest industry has been unable to meet the increased demand for wood products that has been associated with the country's modernization drive.

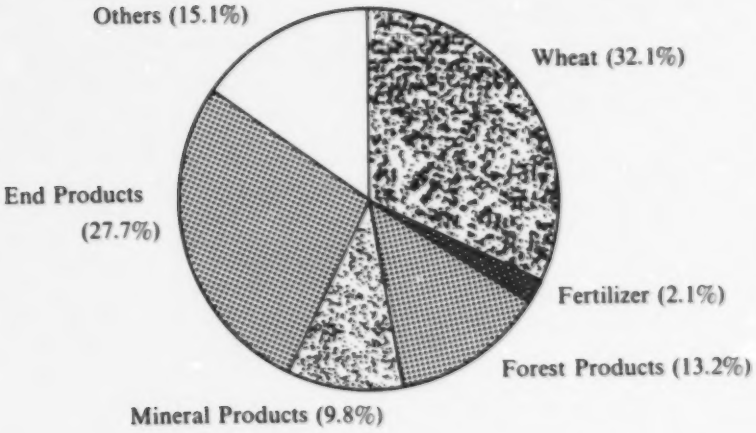
Canada is a world exporter of pulp, paper and lumber, and these have all become important exports to China. As shown in Figure 13.2 (p. 137), forest products comprised 13.2 percent of Canada's total 1986 exports to China. In dollar terms, this amounted to CDN

[4] "Cultivating China's agricultural market," *CanadExport*, Vol. 5, No. 5, March 11, 1987, p. 5.

[5] "Livestock exports underway as China's doors open up to us," *CanadExport*, Vol. 3, No. 13, July 2, 1985, p. 3.

[6] "Cultivating China's agricultural market."

Figure 13.2
Canada's Exports to the PRC
1986



$144.86 million. Wood pulp was the largest single forest export with sales totalling CDN $77.62 million. It was followed by paper (CDN $39.01 million), paperboard (CDN $16.06 million), and softwood lumber (CDN $ 12.02 million).

The value of Canada's forest exports to China has increased over sevenfold since 1975. This growth trend is likely to continue. China's modernization emphasis on education and light industry will stimulate demand for pulp and paper. Education requires increased amounts of paper for books and newspapers, and light industry, with its export orientation, requires increased amounts of paperboard for use in packing and shipping. Demand for imported lumber will similarly grow as the rapid expansion currently taking place in residential and industrial construction, rail and coal industries will cause increased demand.

In an effort to sell more lumber for rural housing construction (of which there are an estimated 10 million starts per year),[7] the British Columbia Ministry of Forest and Lands and the Council of Forest

[7] "Forestry products find China home," *CanadExport*, Vol. 5, No. 11, June 3, 1987, p. 3.

Industries (COFI) gave to the PRC in June 1987 a "friendship farmhouse." This farmhouse is a showpiece of Canadian wood products, and it is hoped that increased Chinese familiarity with them will result in more export sales.

C. Mineral products

China's vast mineral reserves are considered deficient only in nickel, chromite, and cobalt.[8] The mining sector has nevertheless been severely constrained by energy shortages, transportation bottlenecks and antiquated production techniques. This has necessitated significant imports of some products.

In 1986 Canada exported CDN $108.79 million worth of crude and fabricated mineral products to the PRC. Aluminium (including alloys), and aluminium ores, concentrates and scraps comprised close to 68 percent of this total; nickel and alloys, and nickel in ores, concentrates and scraps, 7.8 percent; copper and alloys, 5.9 percent; and zinc (including alloys), and zinc in ores, concentrates and scraps, 3.3 percent.

The strong performance of Canadian aluminium exports in China appears likely to continue, at least in the near term. China's emphasis on light industry (the major sectoral consumer of aluminium) will mean increased demand for this product, and until it can overcome the infrastructural constraints to the development of its domestic reserves, Canadian producers should be assured of a strong market.

However, China is also anxious to undertake a technological transformation of its metal industries to provide for increased production and reduced energy consumption. Joint ventures and technology transfer agreements are methods preferred by China to achieve this objective. Several large Canadian firms have entered into such arrangements. Alcan Aluminium Ltd. (through its Japanese subsidiary, Nippon Light Metal Co.) is involved in a joint venture to build an aluminium reduction plant in Guizhou province;[9] and Noranda Inc. has concluded an agreement with Tianjin Non-Ferrous Metals Industrial Corporation Co. to carry out a feasibility study on the construction of a joint venture copper smelter and refinery.[10]

[8] K. P. Wang, "China's Mineral Economy," *China's Economy Post-Mao*, (Washington, D.C.: U.S. Congress Joint Economic Committee, 1978), p. 378.

[9] K. P. Wang, "China's Mineral and Mining Industries," in D. C. Buxbaum et al eds., *China Trade, Prospects and Perspectives*, (New York: 1982), p. 148.

[10] "Canadian contracts and projects in China," *The Globe and Mail*, April 6, 1987, p. C20.

D. End products

There has been a meteoric rise in the export of end products, including advanced technology and machinery, from Canada to China. In 1984, sales were worth CDN $26.13 million, only 2.1 percent of total exports. Two years later however, the figure had jumped to CDN $304.61 million. End products comprised over 27 percent of Canada's total exports to China in 1986. The main end product exports were: drilling, excavating and mining machinery, CDN $125.18 million; motor vehicles (other than passenger automobiles and trucks), CDN $64.87 million; aircraft and aircraft parts, CDN $49.57 million; telecommunications and other related equipment, CDN $13.51 million; measuring, laboratory, medical, and optical equipment, CDN $7.17 million; and office machines and equipment, CDN $5.92 million.

In recognition of the fact that the transfer of technology to China will often aid export sales, a number of Canadian manufacturing companies have entered into joint ventures with Chinese partners. One of the largest involves the firm of Babcock and Wilcox Canada. This firm has taken over the management of a boiler factory previously run by Beijing Boiler Works. Production has subsequently risen and employees are being trained in more advanced technology.[11] At the same time, Babcock and Wilcox Canada, as part of an international consortium that will build four coal fired power plants in China, has been awarded a CDN $200 million contract to provide "four steam drums for the Huaneng International Power Development Corporation's (HIPDC) Shijiazhuang and Nantong power plants."[12] Other Canadian firms involved in joint ventures include Polysar Ltd., a latex plant; United Tire and Rubber, a tire plant; Mitel Corp., telecommunications; and Semi-Tech Microelectronics Corp., microcomputers.[13]

The recent climb of Canada/China end product trade in part reflects a two year spending spree by many Chinese agencies. This spree was largely responsible for a 1986 trade deficit of US $9.1 billion and has prompted government measures to reduce capital spending.[14] For the first six months of 1987 Canada's trade in end

[11] James Rusk, "Canadians take major roles in varied Chinese ventures," *The Globe and Mail*, April 6, 1987, p. C18.

[12] "Shanghaied? Simply drumming up sales," *CanadExport*, Vol. 5, No. 12, June 17, 1987, p. 1.

[13] "Canadian contracts and projects in China."

[14] Lawrence Surtees, "Canadians have expertise in key spending areas," *The Globe and Mail*, April 6, 1987, p. C19.

products to the PRC was valued at CDN $34.8 million, only 37 percent of the amount for the same period in the previous year. However, this is unlikely to be a long-term decline. Canadian manufacturing firms remain well placed to capture future contracts in China. The PRC's seventh five-year plan (1986-1990) emphasizes the development of economic infrastructure. This augurs well for Canadian exports, particularly in the high priority areas of communications, transportation, energy, and petrochemicals, all of which are fields in which Canada possesses much expertise.

The Canadian government has taken a number of initiatives to facilitate this trade. They include: the provision of a CDN $2 billion line of credit and CDN $350 million of concessional financing; increased trade staff in the Beijing embassy and the opening of a consulate in Shanghai; and the recent supplement to the CIDA budget which will allow it to expand its programs into such areas as transportation and communications.

Table 13.1
Exports to the PRC by Commodity Group
(CDN $ thousand)

Year	*Total Domestic Exports*	*Food, feed, beverages, tobacco*	*Crude materials, inedible*	*Fabricated materials, inedible*	*End products, inedible*	*Others*
1972	260,682	232,876	4,732	22,600	474	
1973	273,293	188,349	10,430	73,151	1,332	30
1974	434,147	334,893	621	96,832	1,694	106
1975	376,422	307,118	7,010	56,384	5,904	6
1976	196,170	142,990	1,247	50,838	1,065	30
1977	369,148	309,621	13,371	45,053	1,070	34
1978	503,427	347,509	12,566	135,781	7,132	438
1979	596,108	411,732	16,789	149,369	18,217	1
1980	866,420	527,575	51,821	278,051	8,836	137
1981	1,017,554	709,791	34,119	255,139	17,746	759
1982	1,227,857	739,091	68,803	413,333	6,450	181
1983	1,607,242	938,564	77,032	579,052	12,529	65
1984	1,236,477	640,304	100,969	463,495	26,132	5,577
1985	1,278,323	467,019	109,629	542,938	156,771	1,966
1986	1,100,278	404,883	81,742	307,173	304,641	1,839
Totals	11,343,548	6,702,315	590,881	3,469,189	569,993	11,169

E. Services

China's service sector is also underdeveloped and the PRC needs to import services if its ambitious modernization objectives are to be realized. It is beyond the scope of this paper to examine trade in services in any detail, but a few brief comments on the export of Canadian services will help to illustrate its importance.

Most of the world's largest banks, including four of Canada's largest, have offices in China. To date, banking operations have been primarily trade related, but Ministry of Finance regulations do allow foreign banks with offices in China to sign loan agreements with individual state enterprises.[15] The Royal Bank of Canada recently led a syndicate of 35 banks that put together US $475 million worth of project financing for the world's largest open pit coal mine in Shanxi province.[16] This same bank has also entered into a joint venture with the China International Trust and Investment Corp. (CITIC) to establish China Investment Finance Ltd., a Hong Kong-based merchant bank.[17] The Bank of Montreal has also joined forces with a Chinese bank. It has an "agreement with the Agricultural Bank of China to promote joint ventures, exchange technology and act as agents."[18]

One constraint on China's economic development is a shortage of skilled workers. Major upgrading in technical and managerial skills is required. Canada has been very active in facilitating this upgrading. CIDA aid has been particularly important in the development of China's human resources. CIDA has over CDN $100 million to fund programs in "management training, language training, satellite communications, forestry management, agricultural development, technical feasibility studies and municipal planning training."[19]

One of the major feasibility studies funded with the CIDA money is the Three Gorges hydroelectric project in China. A Canadian consortium has been awarded two contracts worth CDN $10.1 million to examine the viability of building the world's largest dam on the Yangtze River, constructing a transmission network to take the power generated at the dam to Central and East China, and providing flood protection and improved riverine navigation. If the

[15] "China clarifies regulations on loans by B foreign banks," *The Asian Wall Street Journal Weekly*, July 4, 1983, p. 2.

[16] Lawrence Surtees, "Canadians have expertise in key spending areas."

[17] Robert Grieves, "CITIC may issue bonds in New York," *The Globe and Mail*, April 6, 1987, c. C16.

[18] "Canadian contracts and projects in China."

[19] "Canadian contracts and projects in China."

dam is built, Canada's early involvement should increase the likelihood of future exports sales in what is estimated to be a US $10.6 billion project.[20]

IV. Imports

A. Apparel, Textiles, Cotton

Apparel (outerwear, accessories, and footwear) is China's largest export to Canada. Since 1972, apparel has accounted for 38.9 percent of all Canadian imports from China and sales have risen from CDN $16.44 million to the 1986 level of CDN $210 million. In 1986, imports of outerwear (except knitted) totalled CDN $103.46 million; knitted outerwear, CDN $41.57 million; other apparel and apparel accessories, CDN $56.41 million; and footwear, CDN $8.57 million.

Canada imported CDN $60.48 million worth of Chinese textiles in 1986. Broad woven fabrics (both cotton and mixed), comprised close to 86 percent of this total. Other broad woven fabrics and other textile fabricated materials made up the rest.

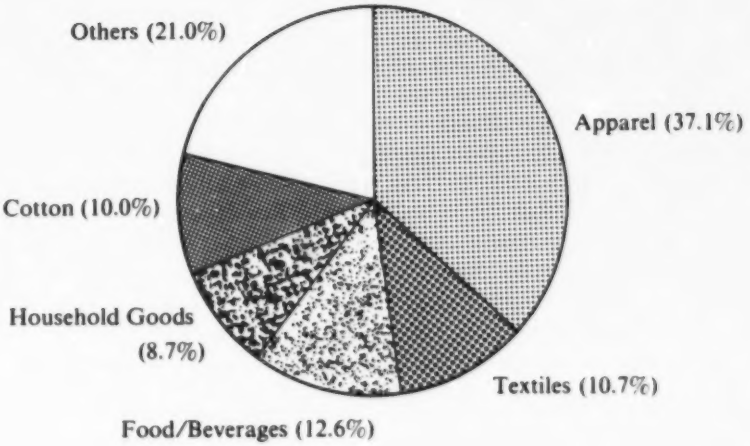
The sale of raw Chinese cotton to Canada increased dramatically in 1986 and accounted for 10 percent of total imports. The dollar value of sales jumped from CDN $386 thousand in 1984, to CDN $2.7 million in 1985, and to CDN $56.6 million in the following year. Sales for the first part of 1987 have not lived up to the 1986 levels, but at CDN $9.44 million still represent a substantial increase over the total sales in all other years. Raw cotton appears to have established a solid foothold in Canadian markets.

With the exception of raw cotton, China's export to Canada of the above commodities has increased steadily since the early 1970s. Sales continue to grow and in the first part of 1987, both apparel and textiles imports were up appreciably from the same period for the previous year. However, China has been unable to greatly expand the export of these goods primarily because of Canadian import quotas, but Canada's Ambassador Richard Gorham, has pointed out another possible factor—the "lack of aggressive [Chinese] salesmanship."[21]

[20] "Project has promise," *CanadExport*, Vol. 4, No. 12, Aug. 11, 1987, p. 6.

[21] James Rusk, "Embassy efforts to promote trade show results," *The Globe and Mail*, April 6, 1987, C8.

Figure 13.3
Canada's Imports from the PRC
1986



B. Food, Beverages

In 1986 Canada imported CDN $71.43 million worth of food and beverages from the PRC. This represented a 31 percent increase from the 1985 level. The majority of this increase can be accounted for by a 323 percent rise in Canadian purchases of fish and marine animals, which jumped from CDN $6.11 million to CDN $25.9 million. Import growth for these products is continuing into the current year, with Chinese sales to Canada for the first half up CDN $4.47 million from those for the same period in 1986.

Canada also purchases large amounts of vegetables and vegetable preparations from the PRC. Sales in 1986 amounted to CDN $24.43 million. Nuts (except oil nuts) were the third largest food commodity that Canada imported from China, with 1986 exports totalling CDN $11.34 million. Sales for 1987 will be considerably greater with imports for the first half exceeding CDN $15 million. Oil seeds, oil nuts, and oil kernels are also important items in the flow of goods from China to Canada. Their value in 1986 was CDN $10.45 million.

1987 figures show that edible oil products also have strong growth potential, with Canadian sales for the first half surpassing by over 70 percent the total sales for 1986.

C. Household Goods

Household goods made up 8.7 percent of Canada's total imports from China in 1986. The sale of furniture was valued at CDN $30.88 million; kitchen utensils and cutlery, CDN $6.95 million; and other personal and household goods, CDN $11.28 million. Sales in 1987 again indicate a significant increase in Canada's import of these commodities. In the first six months of 1987 household goods worth CDN $30.54 million entered Canada. This was a 31 percent increase from the same period in 1986.

D. Joint ventures

Although most Canada/China joint ventures are located in China, the Chinese government has made its second largest overseas investment in Canada. The China International Trust and Investment Corporation has joined forces with two Canadian firms, Consoli-

Table 13.2
Imports from the PRC by Commodity Group
(CDN $ thousand)

Year	*Total imports from the PRC*	*Food, feed, beverages, tobacco*	*Crude materials (inedible)*	*Fabricated materials (inedible)*	*End products (inedible)*	*Other*
1972	48,377	6,429	3,509	13,918	24,284	237
1973	52,904	7,851	2,665	12,216	29,728	444
1974	60,871	9,687	3,315	16,347	31,364	158
1975	56,328	9,352	3,547	10,965	32,355	109
1976	88,348	9,226	3,885	15,949	57,186	2,102
1977	82,154	15,966	957	12,251	51,281	1,699
1978	94,599	19,450	1,047	21,323	50,998	1,781
1979	167,451	33,440	1,356	46,219	83,546	2,890
1980	154,911	22,498	1,331	37,232	90,095	3,755
1981	220,013	26,252	34,081	45,619	110,360	3,701
1982	203,654	32,777	4,316	42,605	119,281	4,675
1983	245,767	35,299	4,698	44,222	156,598	4,950
1984	333,502	36,604	13,910	66,194	213,001	3,793
1985	403,475	54,682	11,657	79,439	250,678	7,019
1986	566,594	71,425	75,003	89,117	323,818	7,231
Totals	2,778,948	390,938	165,277	553,616	1,624,573	44,544

dated Bathurst Inc. and Power Corp. of Canada, to purchase a pulp mill in Castlegar, British Columbia. The mill, which was formerly owned by the British Columbia Resources Investment Corporation, will be managed by the joint venture company of Power Consolidated (China) Ltd. and will provide China with a secure source of pulp.[22]

V. Issues

A. Canadian Protectionism

Although Canadian trade policy is committed to establishing an open international trading environment, it also maintains mechanisms to "deal with unfair trade practices and/or disruptive changes in trade patterns which cause or threaten injury to domestic producers or call for too rapid a structural adjustment."[23] This safeguard clause allows Canada to restrict the import of textiles, apparel and footwear from China and other Asian countries. Voluntary export quotas have been the most common method of restriction, but direct quotas and tactics such as excessive customs inspection have also been used.

It is ironic that Canada should maintain barriers to Chinese imports at the same that it has identified China as a priority export market. These trade barriers were erected to allow Canadian textile and clothing industries time to become internationally competitive, but evidence of readjustment is minimal and the continuation of protectionist policies could impact negatively on the future of Canada's export trade with China.

B. Export of High Technology

It is estimated that in the next five years China will spend close to CDN $5 billion on its telecommunications industries.[24] Canadian companies have been relatively successful in capturing a share of this market, but the export of many technologically sophisticated goods is restricted by national security considerations. The export of high-tech goods from Canada to China requires the approval of the Canadian government and of COCOM, an organization that co-ordinates the export of sensitive military equipment by member nations. In 1986 Canada eased controls on a number of sensitive

[22] Robert Grieves, "CITIC may issue bonds in New York."

[23] Canada, Ministry of External Affairs and Ministry of State for International Trade, *Canadian Trade Policy for the 1980s, A Discussion Paper*, (Ottawa: 1983).

[24] Lawrence Surtees, "Canadians have expertise in key spending areas."

exports to China[25] but its regulations remain stricter than countries such as Japan and West Germany who have taken the lead in high-tech trade with China.[26]

C. Foreign Investment in China

China considers foreign investment, including joint ventures and foreign-owned enterprises, to be an integral part of its strategy for economic development. It is to serve as a conduit for the transfer of technology from the west and to generate much needed foreign currency. However, investors face many problems when they set up shop in China. There has been much complaint about the high cost and low productivity of staff, taxation, inadequate infrastructure and perhaps most significant of all, the "lack of foreign exchange to finance the import of raw materials and remittances of profit."[27]

This less than favourable climate contributed to a 47 percent drop in foreign investment in 1986, the first drop since the beginning of the "open door" policy. To redress this situation, China adopted the *Provisions for the Encouragement of Foreign Investment*, on October 11, 1986. These provisions provide a number of incentives to foreign investors, particularly export oriented and technologically advanced enterprises.[28] Although these measures should help to alleviate concerns, a legislative response will not resolve the structural weaknesses of the economy, which are the source of many of the problems. Declining foreign investment in the near term has been predicted by a number of analysts.[29]

VI. Conclusions

China is firmly committed to the task of rapidly modernizing its economy, and foreign participation is a key part of the program it has implemented to accomplish this goal. Without the infusion of imported goods and services the achievement of its development targets will be very difficult. Modernization also enjoys wide-spread public support, making a reversal of the "open door" policy even more unlikely.

[25] "China export controls eased," *CanadExport*, Vol. 4, No. 4, Feb. 24, 1986, p. 3

[26] Lawrence Surtees, "Canadians have expertise in key spending areas."

[27] Paul E. Brace, "Leaders trying to solve problems facing investors," *The Globe and Mail*, April 6, 1987, p. C8.

[28] "Further Encouragement Of Foreign Investment," *Sino-British Trade Review*, No. 269, February 1987.

[29] Robert Thompson, "China tries to halt fall of foreign investment," *The Globe and Mail*, April 6, 1987, p. C14.

Canada's past export trade with the PRC has been dominated by primary products, particularly wheat. From 1984 to 1986 wheat sales fell dramatically; however, a reversal of this decline appears to be taking place in 1987. Despite this upturn, it must be remembered that China is basically self-sufficient in food production, and with improvements to the transportation system, which will enable more effective distribution of grain, and the likely implementation of a number of measures to arrest the trend in the agricultural sector of switching from grain production to more profitable crops, China's long-term needs for foreign grain should diminish. China will no doubt continue to be a market for Canadian wheat, but the future for export sales does not seem as bright as the past.

Reduced wheat exports should be largely offset by an increase in the sale of end products, which have risen dramatically in the last several years. China has given high priority to improving its economic infrastructure, particularly the transportation, telecommunications, and energy sectors. These are all fields in which Canadian firms possess great expertise and are internationally competitive. Exports in these areas will also benefit from the massive CIDA program and the willingness of a number of large Canadian firms to enter into technology transfer agreements and joint ventures.

On the import side, an increasing volume of goods from the PRC is entering Canada. This trend is likely to continue as Canadian consumers become more familar with China's products and Chinese firms become more familar with the Canadian economy. Canadian quotas on Chinese textiles and apparel will most certainly be subject to considerable pressure for reduction. Pointing to its recurring trade deficit with Canada, China can be expected to demand a more equal trading relationship, and greater penetration of the Canadian market by Chinese clothes and fabrics is a distinct possibility.

All factors considered, it is reasonable to project that Canada/China trade will expand in the future. This projection must be tempered by the realization that the volume of bilateral trade, albeit significant, is unlikely to become a major component of either country's multilateral trade. Nevertheless, many excellent trading opportunities exist, and exporters on both sides of the Pacific should pursue their development.

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COVER PAINTING: "Drying Grain" by He Yaling

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